

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

The City of Pekin, a Municipal Corporation	:	
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	:	
Petition for Approval Pursuant to 735 ILCS 5/7-102 to Condemn a Certain Portion of the Waterworks System of Illinois-American Water Company.	:	02-0352
	:	
	:	

ORDER

DATED: January 22, 2004

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By the Commission:

I. PROCEDURAL HISTORY

On May 10, 2002, the City of Pekin ("City") filed a Petition seeking authority from the Illinois Commerce Commission ("Commission") pursuant to 735 ILCS 5/7-102 to institute eminent domain proceedings against Illinois-American Water Company ("Illinois-American" or "IAWC"). Specifically, the City seeks authority to condemn the "waterworks and related properties" of Illinois-American used to provide water service to residents of the City and the surrounding areas under Division 130 of the Illinois Municipal Code 65 ILCS 5/11-130-9 ("Division 130"). The assets sought by the City comprise Illinois-American's Pekin District.

On September 17, 2003, the City filed the direct testimonies and accompanying exhibits of five witnesses: Richard Hierstein (City Manager), Dennis Kief (Public Works Director), John Janssen (Fire Chief), Leta Hals (consultant with Raftelis Financial Consulting, PA), and R. David Tebben (former Mayor). Thereafter, on March 5, 2003, the Staff of the Commission ("Staff") filed the direct testimonies of two witnesses: William R. Johnson (Water Department, Financial Analysis Division) and Rochelle Phipps (Finance Department, Financial Analysis Division). On that same day, IAWC filed the direct testimonies and accompanying exhibits of ten witnesses: Terry L. Gloriod (President of Illinois-American), Frederick L. Ruckman (Vice President and Treasurer), Mark L. Johnson (Vice President Engineering), Randy West (Operations Superintendent), Kevin Hillen (Northern Division Manager), Brent Gregory (Director of Water Quality), Mary Kane (First Vice President of Stifel Nicolaus), Yvonne Ciccone (Chemical Engineer at Science Applications International Corporation), Richard Riethmiller (Principal-In-Charge Burgess & Niple (Utility Property Valuations)), and Robert Reilly (Professional Appraiser Willamette Management Associates). On April 11, 2003, the City filed the rebuttal testimonies of six witnesses: John Janssen, Robert A. Reis, Sr. (Treasurer and Financial Director for the City), Dennis Kief, Richard Hierstein, Carl Adams (consultant with The Advent Group, Inc.), and Leta Hals. Thereafter on May 6, 2003, Staff filed the rebuttal testimony of three witnesses: William R. Johnson, Rochelle Phipps and Thomas Q. Smith (Accounting Department, Financial Analysis

Division). That same day, IAWC filed the rebuttal testimonies of ten witnesses: Terry L. Gloriod, Frederick L. Ruckman, Mark L. Johnson, Randy West, Kevin Hillen, Brent Gregory, Mary Kane, Yvonne Ciccone, Robert Reilly and Thomas R. Stack (consultant regarding regulatory matters). On May 12, 2003, the City filed the surrebuttal testimony and accompanying exhibits of six witnesses: Robert A. Reis, Sr., Dennis Kief, Richard Hierstein, John Janssen, Dr. Carl Adams, and Leta Hals.

An evidentiary hearing was held from May 19, 2003 to May 23, 2003. At the hearing, the City, Illinois-American and the Staff appeared and were represented by counsel. At the hearing, testimony was heard and admitted on behalf of the above-listed witnesses. At the hearing held on May 23, 2003, the matter was marked "Heard and Taken."

A Briefing Schedule was established and the City, IAWC and Staff all filed Briefs and Reply Briefs in this matter.

A copy of the Administrative Law Judge's Proposed Order was served on the parties. The City, IAWC and Staff all filed Briefs on Exceptions and Replies to Exceptions. All Briefs and Replies are duly considered herein.

II. PROPOSED CONDEMNATION AND COMPANIES INVOLVED

In this proceeding, the City seeks authority to file a court action to condemn the assets of Illinois-American's Pekin District both within and outside the City's municipal boundaries. The City claims to have statutory authority for the condemnation under Division 130.

Illinois-American is a corporation duly organized and existing under and by virtue of the laws of the State of Illinois and is a public utility within the meaning of the Illinois Public Utilities Act (the "Act"). Illinois-American has its principal office in Belleville, Illinois, and presently provides water utility service to approximately 293,000 customers, or more than one million people in 125 communities in Illinois.

Illinois-American is a subsidiary of American Water Works Company, Inc. ("American"), which is the largest investor-owned water utility holding company in the United States. Certain subsidiary companies of American provide numerous services to its operating utility subsidiaries, including Illinois-American. Those services include access to short-term and long-term capital, cash management, administrative, engineering, human resources, risk management, and water quality services, among others. In Docket 01-0832, the Commission approved a reorganization under which American became a second tier subsidiary of Thames Water Aqua Holdings GmbH ("Thames Holdings"), which is a wholly-owned subsidiary of RWE Aktiengesellschaft ("RWE"). The transaction closed on January 10, 2003.

The target of the City's condemnation proposal is the Pekin District of Illinois-American, which encompasses the City of Pekin, as well as parts of the adjacent townships of Groveland, Pekin, Cincinnati and Elm Grove. In 2001, the average daily demand of the Pekin District was 6.837 million gallons per day ("mgd") with a peak daily

demand of 10.526 mgd. At the end of 2001 there were a total of 13,604 customers--- 12,377 residential, 1,057 commercial, 13 industrial, 69 fire and 88 other customers. Approximately 1,200 of the District's customers reside outside of the City's municipal boundaries. The Pekin District includes the following major facilities:

- a. 7 wells with a total pump capacity of 16.82 mgd, estimated withdrawal capacity of 15.43 mgd and reliable withdrawal capacity (largest well out of service) of 12.78 mgd;
- b. 4 water treatment facilities;
- c. 5 distribution storage facilities with a total volume of 4.03 million gallons;
- d. 3 distribution pump stations;
- e. 174 miles of water main;
- f. 963 fire hydrants; and
- g. 2,745 valves.

The Pekin District water system is designed, constructed and operated as an integrated regional grid without regard to municipal boundaries.

III. ROLE OF THE COMMISSION IN CONDEMNATION MATTERS

The Illinois Supreme Court first addressed the authority of an Illinois municipality to condemn public utility property within its municipal boundary in a 1957 opinion, Illinois Cities Water Co. v. Mt. Vernon, 11 Ill. 2d 547 (1957). In that case, the Court held that, so long as all requirements of Illinois law are satisfied, an Illinois municipality can initiate condemnation proceedings to acquire public utility property. Id. at 556. That same year, however, the Illinois General Assembly amended Section 7-102 of the Illinois Eminent Domain Act ("EDA") (735 ILCS 5/7-102) to require that, except in circumstances not relevant here, approval of the Commission must first be obtained to condemn assets of a regulated public utility. In relevant part, that Section provides:

No property . . . belonging to a railroad or other public utility subject to the jurisdiction of the Illinois Commerce Commission may be taken or damaged, pursuant to the provision of . . . this Act, without the prior approval of the Illinois Commerce Commission.

Thus, under the EDA, the Commission has the responsibility to determine whether or not Pekin should be allowed to proceed with a condemnation action.

There have been only a few Commission proceedings conducted under this Section 7-102 of the EDA. One such proceeding is Fernway Sanitary District v. Citizens

Utility Company of Illinois, Docket 52024 (1968). In that proceeding, a Sanitary District sought approval under what is now Section 7-102 of the EDA to condemn water and sewer facilities of a public utility which served a subdivision and adjoining village. The District argued that, under the relevant statutory provisions, it had authority to condemn the utility's facilities both inside the District's boundaries and in the adjoining village.

In its Order in Fernway, the Commission examined in detail the proper scope of its review of a condemnation proposal filed under Section 7-102 of the EDA. Initially (Order, pp. 6-7), the Commission considered whether its role under the EDA was "a mere formal administrative duty" or, "whether the legislature intended for the Commission to inquire into the wisdom of a proposed take over of a private utility . . . ; and determine whether such take over would be in the general public interest and would better protect the users or consumers of utility services." (Docket 52024, Order, p. 6.)

With regard to this issue the Commission concluded that the latter, a broad review of whether a proposed take over is in the better public interest, is what the General Assembly intended. Specifically, the Commission stated as follows:

We cannot believe, however, that the legislature intended for the Commission to approve automatically all proposals by a public district to take over a private utility. It is more logical to believe that the legislature intended this amendment [the language requiring Commission review and approval] to provide a forum to determine in such cases what action would best serve the public, the public interest and the utility users. It will be noted that the court in the condemnation suit cannot consider such question.

(Docket 52024, Order, pp. 6-7.)

With regard to its responsibility to review condemnation proposals, the Commission further stated in Fernway:

...it is not the duty or function of the Commission to determine specifically or directly the value of the property in question but instead it is the Commission's duty to determine whether the public interest will better be served by granting or withholding approval for the district to proceed in an eminent domain action.

(Docket 52024, Order, p. 3.)

In this proceeding, Staff witness Johnson adopted a more limited view of the "public interest" standard, suggesting that the Commission should determine only whether, " . . . customers within the City and those currently served outside the City [would] be any worse off because of the proposed condemnation." [Staff Ex. 1.00, p. 6.] Even under this limited standard, Staff witness Johnson concluded that the City's Petition should be denied, pointing out that, if the City were to acquire the water system, it would be free to adopt policies that discriminate against water customers that are non-residents of the City. Staff witness Johnson concluded that non-resident customers

would be "worse off" under City ownership and that acquisition of the water system by the City would, therefore, not serve the public interest.

As explained by IAWC witness Stack, however, the City should actually be held to a higher standard of proof than that suggested by Staff witness Johnson. Specifically, as discussed by the Commission in Fernway and other proceedings that involve competing (mutually-exclusive) proposals set forth in the evidentiary record, a public interest analysis should not simply evaluate a filed proposal and determine whether it renders members of the public "worse off." Instead, as Mr. Stack explained, the Commission has determined that, under the public interest standard, it should examine competing proposals and approve the filed proposal only if it is shown to be "better" than the alternative. [Id., pp. 4-6.]

This interpretation of the public interest standard is consistent with that adopted in our prior orders affirmed by the Illinois courts in Illinois Power Co. v. Commerce Comm., 111 Ill. 2d 505 (1986) (in case involving a proposed merger, Commission concluded that filed proposal should be approved only if shown to be in "better" public interest); and Klopf v. Commerce Comm., 54 Ill. App. 3d 491 (1997) (Commission denied approval for sale of property to adjoining landowners, finding instead that the public interest would be better served by the plan of an intervenor, the Department of Conservation, to use the land as a nature trail).

Also relevant to the decision in this case is identification of the party with the burden to show that its proposal is in the "better" public interest. Where a party seeks affirmative relief by filing a Petition, that party bears the burden of proof. The Commission's practice of assigning the burden of proof to petitioners in Commission proceedings is consistent with Illinois law, which confirms that the petitioner or party seeking affirmative relief bears the burden of proof. Bell v. School Dist., No. 84, 407 Ill. 406, 416-17, 95 N.E.2d 496, 501 (Ill. 1950). In this proceeding, the Commission determines that the City bears the burden to prove that its proposal to condemn the Pekin District assets needed to serve both residents and non-residents of the City is superior from a public interest standpoint to continued ownership and operation of those assets by Illinois-American.

IV. PUBLIC INTEREST ANALYSIS

A. Pekin's Position

1. Legal Standard

The City's Petition to acquire the Pekin Water District (Pekin District) from Illinois American Water Corporation (IAWC) was filed under Code of Civil Procedure § 7-102, which the City notes does not contain a "public interest" or "public convenience" requirement. The City indicates that Staff pointed out that the Commission's role under that statute is to ensure "that property necessary for utility purposes is not taken." See Department of Conservation v. Chicago & North Western Transportation Co., 59 Ill. App. 3d 89, 91 (1978). Accordingly, the City submits that its Petition should not be evaluated

"as a competing alternative" that must serve the public interest "better" than IAWC's continued ownership. However, the City notes that it has argued that its Petition should be approved even if the Commission adopts the more stringent public interest standard.

2. City acquisition is in the public interest

a. City acquisition has citizen support

The City asserts that, despite IAWC spending approximately \$1.5 million on advertising campaigns against the last two referendums, the most recent advisory referendum found 61% of the City voters in favor of City acquisition. [Pekin Ex. 1.0, p. 8; Tr., pp. 740-741.] The City maintains that the voters have voiced their desire and their view of what is in the public interest – the acquisition of the Pekin District.

Additionally, the City submits that in 1998, it created a Water Study Task Force Committee ("Water Task Force") to study the potential benefits and detriments that would result from the City's acquisition of the Pekin District. [*Id.*, p. 4; Pekin Ex. 1.1, p. 1.] The Water Task Force was comprised of a variety of citizens who live within the Pekin District's service area, including areas outside the City limits but within the territory serviced by IAWC through the Pekin District. [Pekin Ex. 1.0, pp. 4-5.]

According to the City, the Water Task Force studied all aspects of City acquisition – gathering information from many sources, including IAWC. At the conclusion of its study, the Water Task Force prepared a 65-page report supporting its recommendation to the City Council to move forward with the acquisition of the Pekin District. [*Id.*, p. 2; Pekin Ex. 1.0, p. 6.] The Water Task Force based its recommendation on issues of City control of its natural resources and rates for water, finding: City ownership will "significantly reduce future rate increases"; "keep significant cash flow and profit dollars in the City"; "allow the integrated planning of infrastructure (roads, sewer, water) maintenance"; "provide additional means to help manage future City growth"; and might also "provide additional jobs" in the City. [*Id.*; Pekin Ex. 1.1, Letter of Recommendation.]

The City further points out that two different City Councils, the elected representatives of the people, have unanimously voted to exercise the powers and authority given them by the Illinois legislature to condemn the waterworks.

b. City acquisition will result in an expeditious resolution of current fire protection and public safety concerns

According to the City, in recent eminent domain proceedings this Commission has considered public safety an important determination in ascertaining the "public interest." See, e.g., Department of Transportation v. Union Pacific Railroad Co., Sept. 25, 2002 Order, Case No. T02-0044, 2002 WL 31477179 (ICC 2002) (granting easements for construction of an overpass over railroad tracks to enhance the public safety and convenience); Department of Transportation v. Illinois Central Railroad Co., Jan. 24, 2002 Order, Case No. T01-0060, 2002 WL 1156035 (ICC 2002) (granting right-of-way for improvement of state route for purpose of improving public safety). The City

asserts that acquisition will place control of these public safety issues squarely in the hands of the City and its elected officials.

(i) Small diameter mains

The City points out that portions of the Pekin District date back to 1886. [Tr., p. 894.] The City states that it has advised IAWC and IAWC's Vice President of Engineering has acknowledged that many of the distribution mains throughout the system are too small to provide sufficient fire flow capacity. [Pekin Am. Ex. 2.0, p. 3; Pekin Ex. 1.0, p. 13; Tr. pp. 946-947.] The City contends that, as recently as last year, the City's fire department was unable to stop a local business, Jim's Automotive, from burning to the ground. [Id., p. 431; Pekin Am. Ex. 3.0, p. 4.] The City's Fire Chief opined that because of the old water mains, the fire department was unable to supply its vehicles with enough water to even make headway against that fire. [Id.]

The City contends that IAWC's 30-year statewide small main replacement program does not adequately resolve this important issue of City control. IAWC acknowledged that its statewide strategic plan for small main replacement is subject to IAWC's ever-changing financial conditions. [Id., p. 956.] The City points out that IAWC's main replacement program is subject to IAWC's statewide capital plan, which necessarily requires adjustment after any new acquisition or merger. [Id., pp. 929-931.] IAWC's capital improvement planning is neither reviewed by the Commission nor subject to Commission approval. [Id., pp. 933-934]. As such, the City posits that if a decision is made by IAWC to alter, defer or cancel a planned capital improvement, such as the small main replacement program, neither the City nor the Commission will have input or review of that decision. [Id., pp. 934-935.] City acquisition of the Pekin District will place control of these issues squarely in the hands of Pekin.

The City submits that upon acquisition it plans to "aggressively replace the inadequate mains, so that all areas of the City are served with acceptable pressures in the event of fire." [Pekin Ex. 1.0, p. 13; Tr. p. 436.] The City avers that it has demonstrated through its testimony in this matter that its adjustments to water main replacement can be made with only local interests and municipal and fire department priorities in mind. [Pekin Am Ex. 7.0, p. 11; Pekin Ex. 1.0, p. 13.] According to the City, local municipal ownership will also allow the City to tap into a variety of funding sources that are unavailable to private enterprises like IAWC. [Id., p. 18.] The City maintains that this flexibility and availability of funding resources will allow the City to address the fire concerns posed by the small water mains in the most expedient manner, enhancing the public safety.

The City asserts that its ability to fund an accelerated main replacement program is concisely proven by a comparison of IAWC's actual capital improvement expenditures for the years 2003-2012 with Ms. Hals' feasibility analysis that maintains the five-year rate freeze. The capital improvement numbers shown in Ms. Hals' original Schedule A-2 were an estimate of what Ms. Hals determined are necessary capital improvement expenditures for the Pekin District given RFC's extensive experience in the water industry – approximately \$20 million for the ten-year period from 2003-2012. IAWC's

actual capital improvement plans for the years 2003-2012 total only \$11.2 million. As such, the City submits that City acquisition results in the five-year rate freeze while spending over \$8.8 million more than projected by IAWC for its capital improvement expenditures in the same timeframe. [Pekin Ex. 8.0, pp. 16-19, Ex. 8.2]

(ii) Gravel in the water mains

The City argues that the record in this proceeding also demonstrates historical and ongoing problems with gravel in the water mains. [Tr., p. 432; Pekin Am. Ex. 3.0, p. 5.] It states that while IAWC contends no evidence of this gravel problem actually exists, IAWC's own witness, Randy West, testified that he was aware of gravel in a hydrant. [Tr., p. 991.] The City's Fire Chief explained that this gravel could destroy the fire department's fire pumps and valves if the fire department does not continually take the precautionary step of flowing the hydrant water before allowing it into the City's fire equipment. [Pekin Am. Ex. 3.0, p. 5.] The City contends that this problem would be improved through the increased accountability and local control that would be available through City ownership of the system. [Tr., pp. 432-433.]

c. The City can acquire and operate the system, implement the necessary capital improvements and maintain fair rates

As part of the City's investigation of whether it should attempt to acquire the Pekin District, Rafetelis Financial Consulting, PA ("RFC") prepared a financial feasibility analysis. RFC concluded it is financially feasible for the City to acquire and operate the Pekin District, make capital improvements proposed by IAWC, and have a revenue surplus from the Pekin District to fund a more expeditious replacement of the system's small mains.

(i) Ms. Hals and RFC are qualified professionals

The City refutes IAWC's assertions that question the experience and expertise of Ms. Hals and RFC. The City notes that Ms. Hals has a Masters of Business Administration in Finance and, as demonstrated by her curriculum vitae, experience in a broad variety of financial valuation, economic impact, and feasibility projects involving public utilities and, more specifically, water utilities. [Pekin Ex. 5.1.]

The City also notes that Ms. Hals had the benefit of the resources and expertise of RFC, which testimony demonstrates is a highly experienced and reputable management and financial consulting firm in the water industry. Specifically, the City points to the fact that RFC has conducted at least 18 water utility valuations for communities throughout the United States, including several analyses that involved subsidiaries of AWWC. [Id., pp. 2-4.] The City further notes that "[a]s a part of the valuation analysis, the majority of these engagements included financial feasibility analyses to estimate customer rate impact and long-term economic impacts associated with communities purchasing the water system that serves its constituents." [Id., p. 3.]

The City explains that IAWC attempts to attack Ms. Hals' credibility by implying that her valuation analysis fails to conform with the American Society of Appraisers ("ASA") Appraisal Standards. However, the City asserts that IAWC's valuation expert had the opportunity to challenge Ms. Hals relative to the ASA standards, but never cited any specific standard promulgated by ASA, or any other authoritative body, to demonstrate how Ms. Hals failed to meet that standard. The City further contends that, even with respect to IAWC's biggest criticism – Ms. Hals' exclusion of RCNLD – IAWC was unable to point to any source to prove that Ms. Hals' methodology in this regard was flawed. The City believes that the record supports the credibility and qualifications of Ms. Hals and RFC.

(ii) Savings available only to municipally-owned utilities

The record is clear, including support from IAWC's valuation expert, that publicly owned utilities may benefit from cost savings that are not available to privately-owned utilities. This is because municipal owners can issue bonds resulting in lower capital costs, can access state and federal loan programs at very favorable rates, do not need to provide a return on investment to shareholders, and are not required to pay income or property taxes. [Pekin Ex. 1.0, pp. 18-19, Pekin Ex. 5.0, p. 8, IAWC Ex. 10R, p. 14.] The City also emphasizes that Staff identified these facts as benefits of City ownership of the system. [Tr., pp. 72-73; Staff Ex. 1.0, p. 6.]

The City highlights that IAWC's own witness recognized the City's access to funding sources unavailable to IAWC. [Tr., p. 983 (acknowledging a grant received by the City but not available to IAWC).] The City contends economic savings are also possible because of IAWC's high cost of common equity of 11.015%, which makes up more than 45% of its capital structure. [Pekin Ex. 8.0, p. 24.] According to the City, IAWC's rate of return on equity is significantly higher than the City's cost of debt. [Pekin Ex. 17.0, p. 24.] These savings are not available without City ownership.

The City maintains that these savings, all of which were highlighted in RFC's financial feasibility analysis, illuminate the financial benefits of City acquisition and illustrate that the public interest will be served.

(iii) A rate freeze, as well as a reduction in future rate increases

The City explains that the savings available to municipally owned utilities allow those utilities to charge less for their services. For example, the City points to RFC's analysis, which illustrates that the current end-user rates under IAWC's private ownership are 19% higher than the average rates of neighboring water systems, most of which are publicly owned. [Pekin Ex. 5.0, pp. 15-16.] The City also notes that this finding was further supported by the City Manager's rate comparison with several other cities, which concludes "the Pekin rate is at or near the top." [Pekin Ex. 1.0, p. 21.]

The resolution to acquire the Pekin District passed by the City Council included a five-year rate freeze for all customers of the Pekin District. [Tr., p. 209.] The City maintains that the feasibility of this rate freeze, as well as lower rate increases and customer bills in the future under municipal rather than private ownership, was demonstrated in the financial feasibility analysis prepared by RFC. [Pekin Ex. 5.0, pp. 13-14.] As summarized by City witness Hals, “Although RFC’s analysis projects no rate increases for six years, the City of Pekin has indicated a rate moratorium for five years. This will allow the City flexibility in its financing plan and the potential to perform additional capital improvements as needed.” [*Id.*, p.13.]

The City argued that its operation and management costs would remain the same as IAWC’s, but considered this assumption to be conservative. According to the City, reductions in operating costs are more likely. First, the City contends that it would not have to support the large overhead costs of the American system or costs associated with regulation. [*Id.*, p. 19.] Second, the City points to the variety of sources from which the City can obtain the advantages of mass purchasing. Specifically, the City notes that the City Manager testified, “As a governmental entity, we are entitled to national and state contracts for nearly every commodity we use. These contracts offer very large discounts. Additionally, we would have available to us the buying power of our contract operator.” [Pekin Am. Ex. 7.0, p. 7.] Third, the City asserts that its competitive bid process for a contractor operator would create an incentive for cost reduction that could result in a 10% reduction in operating costs. [Pekin Ex. 5.0, p. 15; Pekin Ex. 8.0, p. 19.]

(iv) Acquisition is possible while maintaining a strong bond rating

The City explains that the purchase price of the system has only a limited relevance to this proceeding. The City notes that the Commission has recognized that it has no jurisdiction over the price to be paid in condemnation proceedings and that the Commission cannot predict an appropriate price “with any reasonable degree of accuracy.” See County of Lake, p. 4. At the hearing, however, it was indicated that “the amount of indebtedness that the City may be forced to undertake is an issue that needs to be addressed as far as the public interest standard goes.” [Tr., p. 845.] To that end, the City provided detailed evidence supporting RFC’s estimation that a willing buyer and a willing seller would set the value of the Pekin District to be approximately \$14 million. [Pekin Ex. 5.0, p. 10.]

The City contends that RFC’s valuation is significant because Staff’s financial analyst concluded the City’s debt burden would remain low and, thus, its bond rating would be appropriate, if the City pays \$14 million to acquire the system. [Staff Ex. 2.0, p. 14.] The City also notes that Staff’s financial analyst testified that the City’s credit strength is sufficient to acquire and operate the Pekin District without adverse financial consequences if the City’s total debt-issuance remains below \$26 million. [Staff Ex. 4.0, pp. 9-10.] The City concludes that, while it is not this Commission’s responsibility to determine the value of the system, evidence shows that the City could acquire the system at a cost that is 85% above RFC’s professional valuation analysis and still fall within the realm of financial reasonableness established by Staff. Moreover, the City

notes that, after reviewing S&P's use of its benchmarks for establishing ratings, Ms. Hals testified that the City has the flexibility to obtain S&P's approval while incurring debt at a much higher value than Staff's figure of \$26 million. [Pekin Ex. 17.0, pp. 25-26.] The City also notes that testimony at hearing shows that the City would not proceed with acquisition if the purchase price rises to a non-feasible level. [Tr., p. 210.]

(v) The income approach

The City contends that the value paid for property taken in an eminent domain proceeding must represent the fair market value – what a willing buyer would pay to a willing seller. See, e.g., 735 ILCS § 5/7-121. The City explains that in determining what price a willing buyer and a willing seller would agree to for the Pekin District, RFC relied principally on the income approach, but assessed the value of the system under several different valuation methodologies. Ms. Hals “considered all three approaches, as we are required to do, and have decided that some of the approaches will not produce a value that is appropriate in this case because it is not a value that would be paid by a willing buyer.” [Tr., p. 451.] The City submits that it established that the income capitalization approach is the most appropriate in determining the fair market value of the system. [Pekin Ex. 5.0, p. 17.] The City further contends that the income approach is an established method to determine fair market value in Illinois. [Pekin Ex. 17.0, p. 9.]

According to the City, the appropriateness of using an income approach analysis when valuing a regulated industry like a water utility is supported by the fact that the allowed rate of return is regulated, unlike other industries where the rate of return is unknown and somewhat dependent on the capabilities of the buyer. [Pekin Ex. 5.0, pp. 17-18.] The City notes that in a regulated industry, a buyer knows with some level of certainty what its return on investment will be and that those future profits should be the primary driver of a decision to purchase a water utility. [Pekin Ex. 8.0, p. 8.] The City concludes that an income approach, like the one relied upon by RFC in this proceeding, represents “fair market value” because a buyer would unlikely recoup its investment if it paid higher than the income approach value and a rational, willing buyer would not pay a price that would prevent that buyer from recouping its initial investment.

Ultimately, the City asserts that IAWC's protests regarding the appropriateness of the income approach lose all credibility by the acknowledgement of IAWC's President that IAWC itself has used this same valuation methodology to establish a value for utilities it has purchased in transactions where it is the willing buyer. [Tr., pp. 757-758.]

In the process of using the market approach analysis as a reasonableness check, as is evident from both her surrebuttal testimony and her testimony at the hearing, Ms. Hals completed a market analysis comparison that examined: (1) number of customers; (2) date of utility transaction; (3) net utility plant; (4) revenues; (5) earnings before interests, taxes, depreciation, and amortization; and (6) earnings before interest and taxes. [Pekin Ex. 17, p.7; Tr. pp. 476, 519.] After this six-point comparability analysis, Ms. Hals properly concluded that an active market for the Pekin System does exist. Her reasonableness check reaffirmed her conclusion that IAWC's RCNLD value far exceeds the price at which a willing buyer and seller would arrive for the Pekin System. [Id., pp.

481, 486.] Ms. Hals' rebutted IAWC's concern with her use of stock acquisitions in her market reasonableness analysis, by demonstrating that stock transactions are appropriate for a reasonableness check when the debt assumed by the purchaser is considered, as Ms. Hals did. [Pekin Ex. 8.0, p. 4.] The City asserts that the validity of Ms. Hals' decision to not rely upon a RCNLD analysis is consistent with IAWC's admitted practice of not performing a RCNLD analysis when considering the purchase of a water utility. [Tr., pp. 757, 889, 975].

Finally, the City points out that Ms. Hals did not equate the value of the Pekin District with the IAWC made-up term "Original Cost Rate Base (OCRB)." As explained by the City, in Ms. Hals' Schedule B-2, rate base is calculated directly from IAWC exhibits for Docket #00-0340 and is \$11,529,436. [Pekin Ex. 5.2, Schedule B-2.] Ms. Hals' calculation to establish the value under the income approach, however, is much more complex. First, Ms. Hals forecasts operating, depreciation, and tax expenses (Schedule B-1); future rate base calculations (Schedule B-2); and future capital improvements and depreciation accumulations (Schedule B-3). [*Id.*, Schedules B-1, B-2 and B-3.] The City notes that Ms. Hals then uses these factors to forecast the revenue requirements of a hypothetical investor-owned buyer and resulting rate increases and revenues (Schedule B-4). [*Id.*, Schedule B-4.] She uses the ensuing net income, less capital investments, to determine the income available for distribution in the future (Schedule B-5). [*Id.*, Schedule B-5.] This distributable income is discounted to today's dollars to give a net present value for the Pekin District of \$13,969,251. This demonstrated that, not only is Ms. Hals' valuation estimate different from the rate-base calculation, it is actually 21% higher.

d. IAWC's financial analysis is unsupported

(i) Analyses prepared to create the maximum compensation

The City asserts that the only way Mr. Reilly, Ms. Kane, and Mr. Ruckman can support their claims that acquisition is not feasible is to create a valuation that is geometrically above what a willing buyer would or could pay. The City argues that IAWC's valuation, presented by Mr. Reilly and Mr. Riethmiller, is at the heart of Mr. Ruckman's and Ms. Kane's assertions of unreasonable rate increases. It ignores that a willing buyer would not pay a price that would prevent that buyer from recouping its initial investment. Even IAWC witness Gloriod acknowledged that his conclusions were premised on IAWC witness Reilly's suggested acquisition cost of \$60 million. [Tr., pp. 753-754.]

The City points out that IAWC witness Ruckman also acknowledged that his rate analysis assumed the \$60 million valuation calculated by Mr. Reilly. [*Id.*, pp. 974-975.] IAWC witness Kane's testimony is also based on Mr. Reilly's suggested acquisition cost. [IAWC Ex. 7.0R, p. 5.] The City asserts that when Mr. Reilly's \$60 million valuation is adjusted to a reasonable level, all IAWC's challenges to the financial feasibility and public interest of City acquisition fall. The City maintains that Mr. Reilly's \$60 million figure cannot stand under applicable legal standards or the inconsistency of his analysis.

The City argues that, consistent with Mr. Reilly's advice that experts using the key deprivation appraisal (which includes eminent domain) "can provide the kind of informed advice and counsel that clients or employers need to receive the maximum compensation in a deprivation", Mr. Reilly presented a valuation for the Pekin District that is more than four times above what a willing investor-owned utility or a publicly owned utility would be able to recoup. [Tr., p. 909.]

(a) IAWC's inconsistency in assumptions

The City emphasizes that Mr. Reilly's \$60 million valuation figure was based primarily on income and RCNLD valuations. With respect to Mr. Reilly's income approach analysis, the only way Mr. Reilly was able to maximize his asserted value was to hypothesize that the most likely buyer was a municipality that could set rates as high as it would like and yet enjoy the lowest possible expenditures. The City notes that Ms. Hals testified that "[j]ust because a municipality is not regulated does not mean that it will set rates at whatever levels it desires." [Pekin Ex. 17.0, p. 4.] In fact, based on RFC's extensive experience, publicly-owned utilities operate on a break-even basis. Mr. Reilly agreed, testifying that "most municipalities operate utilities on a break even basis." [IAWC Ex. 10R, p. 15.]

The City argues that Mr. Reilly's income analysis ignores the obvious need to use consistent data, which would require either the comparison of investor-owned revenues with investor-owned expenses, or municipal revenues with municipal expenses. As explained by Ms. Hals:

In essence, Mr. Reilly takes the revenues of an investor-owned utility, less the lower costs of a municipal utility to generate the greatest amount of cash flow. By then applying the municipality's lower cost of capital as a discount rate, he is able to invent an over-inflated value by picking and choosing the most helpful financial data from two different types of ownership.

[Pekin Ex. 8.0, p. 11.]

The City submits the bias of Mr. Reilly's analysis is exposed by his own admission that municipalities operate their utilities on a break even basis. [IAWC Ex. 10R, p. 15.] The City notes that Mr. Reilly argued that the most likely buyer of the Pekin District would be a municipal and/or governmentally-owned entity. [IAWC Ex. 10R, p. 11.] Despite this assertion, the City indicates that Mr. Reilly's income analysis is based on investor-owned revenues. [Pekin Ex. 17.0, p. 4.] If Mr. Reilly's objective was to represent a municipality as the most likely hypothetical buyer in his valuation analysis, then the City submits he should have used the most likely financial environment of that same type of most likely buyer. By his own admission the most likely financial environment is the "break even" or "non-profit" nature of municipalities. To the City, this inconsistency confirms Mr. Reilly's bias in this case.

(b) IAWC contradicts its own valuation expert

It is the City's position that the most telling argument against the credibility of IAWC's valuation lies within IAWC's own contradictory testimony. The City notes that IAWC states it is not feasible to purchase the Pekin District at a value of \$60 million, yet continues to insist that is what a willing buyer would pay. On the one hand, IAWC suggests (through Mr. Reilly's valuation) that a willing buyer would pay \$60 million for the Pekin District. Yet, IAWC also argues (through Mr. Ruckman and Ms. Kane) that acquisition of the Pekin District for \$60 million is not feasible because it would result in a 106% rate increase. [IAWC Ex. 2.0, pp. 11-12; IAWC Ex. 2.1, pp. 34.] The City maintains that if acquisition at \$60 million is not feasible, it is not plausible to argue that a willing buyer would acquire the Pekin District at the IAWC valuation of \$60 million.

(ii) Not a "special use" property; RCNLD is inappropriate

The City also asserts that IAWC's use of RCNLD to calculate its \$60 million figure is legally flawed. The City emphasizes that Illinois law requires property taken by eminent domain to be valued at fair cash value. The City notes that there is one very limited exception if the property is a "special use," and that the Illinois' eminent domain statute that addresses condemnation valuations provides:

Except as to property designated as possessing a special use, the fair cash market value of property in a proceeding in eminent domain shall be the amount of money which a purchaser, willing but not obligated to buy the property, would pay to an owner willing but not obligated to sell in a voluntary sale, which amount of money shall be determined and ascertained as of the date of filing the complaint to condemn.

735 ILCS § 5/7-121. The City asserts that, while IAWC goes to great lengths to support its use of the RCNLD valuation methodology, the Pekin District is not a "special use" property.

According to the City, the Illinois Supreme Court has developed a long-standing and highly restricted special use doctrine that is applicable only in a "few exceptional cases in which market value cannot be the legal standard because the property is of such nature and applied to such special use that it cannot have a market value." City of Chicago v. Farwell, 121 N.E. 795, 797 (Ill. 1918) (citations omitted). The City notes that Illinois courts interpreting this "special use" exception have held that the special use doctrine only applies when "the use of property may be so unique or special that it is not ordinarily bought or sold and that therefore no 'market' exists." Department of Public Works and Buildings v. Huffeld, 215 N.E.2d 312, 316 (Ill. Ct. App. 1966), citing Farwell, 121 N.E. 795. The City also notes that Illinois courts have recognized that the "unique" concept within the special use doctrine admits "only a few structures, principally those having historic value, such as a Frank Lloyd Wright house, the Old Capital in Springfield, Holy Name Cathedral in Chicago or The Water Tower." People v. Young Women's

Christian Association of Springfield, 375 N.E.2d 159, 163 (Ill. Ct. App. 1978), *rev'd on other grounds*, 387 N.E.2d 305 (Ill. 1979).

The City recognizes that Mr. Reilly disputes that Illinois courts have defined a special use as “a use where there is no readily ascertainable market value.” [Tr., pp. 878-879]. Yet, the City explains that in Department of Transportation v. Mullen, 457 N.E.2d 1362 (Ill. Ct. App. 1983), the Illinois Court of Appeals explicitly noted that “property is classified as a special use only if it has no readily ascertainable market value, which is something quite different from its unsuitability for other uses.” Id. at 1367. The City also emphasizes that Mr. Reilly admitted at the hearing that he does not have any knowledge regarding, and did not consider, the types of properties that Illinois courts have determined not to be special use. [Tr., p. 889.] According to the City, the special use doctrine has generally been recognized to only apply to churches, colleges, cemeteries, clubhouses, and terminals of railroads. See, e.g., Farwell, 121 N.E. at 797 (citations omitted). The City maintains that a water system is not within the categories of properties previously recognized as special uses by Illinois courts.

The City notes IAWC’s contention that the Pekin District is a “special use” property because of its “limited” marketability, and responds by noting that is not the accepted “special use” standard in Illinois. As noted above, Illinois courts interpreting the special use doctrine have only applied it when “no market” exists. See, e.g., Huffeld, 68 Ill.App.2d at 128-129; see also Farwell, 286 Ill. at 420 (limiting the special use exception to properties that “cannot have a market value”).

The City suggests that the inappropriateness of Mr. Reilly’s RCNLD analysis is also highlighted by the fact that there is a demonstrated market for water utilities of various sizes across the United States. [Tr., p. 463.] The City asserts there have been at least 119 water utility transactions in Illinois alone since 1975. [Pekin Ex. 8.0, p. 1; Pekin Ex. 8.1.] The City also notes that AWWC and its subsidiaries have been involved in many water utility asset transactions. [Pekin Ex. 8.0, p. 3; Pekin Ex. 8.1.] For example, the City indicates that IAWC’s President testified about two transactions involving IAWC, and admitted both transactions involved willing buyers and willing sellers. [Tr., p. 757.] In addition, the City stresses that the Pekin District itself was purchased by IAWC in a private sale in 1982. [Tr., pp. 805-806.] The City also notes that, when asked about potential acquisitions of water systems, IAWC witness Mark Johnson responded that “We always have potential acquisitions on the horizon.” [Tr., p. 939.] According to the City, not only is there an ongoing market for water utilities, but IAWC is an active participant in that market. The City believes that this emphasizes that the Pekin District is not a “special use” property and that the use of an RCNLD analysis is inappropriate here. [Pekin Ex. 8.0, p. 1.]

In an attempt to support its use of RCNLD, IAWC looks to treatises and case law from other states. The City believes this is inappropriate as Illinois courts are clear and other cases have no precedential value in Illinois. In addition, IAWC’s reliance on Massachusetts-American Water Company is inappropriate because, in that case, the condemnor did not contest that the property in question was a special purpose property. See Massachusetts-American Water Co. v. Grafton Water District, 631 N.E.2d 59, 60

(Mass. Ct. App. 1994). The City also notes that the Moon Township case relied upon by IAWC does not involve the acquisition of a water utility for continued use by a municipality, but the condemnation for highway construction at a site uniquely suited for a potential water treatment plant. See Moon Township Municipal Authority Condemnation, 4 Pa. D. & C.3d 421, 421; 424 (Pa. Ct. Cmmn. Pls. 1978). The City also notes that the Moon Township court stated that use of replacement cost valuation is only appropriate “where there is no other way to determine just compensation,” and evidence of replacement value “should not [be] received unless the circumstances were so peculiar as to render it absolutely essential, in the interest of justice, to require its admission.” Id. at 424-425 (citations omitted); see also, Township of Manchester Department of Utilities v. Even Ray Co., Inc., 716 A.2d 1188, 1195 (N.J. Super. Ct. App. Div. 1998) (stating that when comparable sales method of valuation is unavailable, replacement cost is appropriate when condemnation necessitates the provision of substitute sewer facilities; however, “If no substitute facility is necessary, fair market value will be the standard for compensation, when it can be ascertained.”)

The City also submits that IAWC misconstrues the holdings of the Illinois cases cited for the contention that replacement or reproduction is a favored valuation methodology. The City contends that the court in Chicago City Bank & Trust merely cited replacement cost as an example of an alternative valuation method that may be available in cases of a “special use” property. See Chicago City Bank & Trust Co. v. Ceres Terminals, Inc., 93 Ill.App.3d 623, 630 (Ill. Ct. App. 1981). The court in County of Cook allowed evidence of the cost of adjacent land to replace the school property that was taken because the school had a legal obligation to replace the condemned portion. See County of Cook v. City of Chicago, 84 Ill.App.2d 301, 309 (Ill. Ct. App. 1967). In this proceeding, the City notes that IAWC has no obligation to, and will not, replace the Pekin District if it is acquired by the City. Finally, the City submits that in City of Chicago v. George F. Harding Collection, neither the classification of property as “special use” nor the appropriate valuation method was actually at issue. See 70 Ill.App.2d 254, 257 (Ill. Ct. App. 1965). Both parties in that case conceded that the subject property, a museum, was a special use that would be valued at replacement cost or reproduction value to accommodate the relocation of the museum. See id.

(iii) IAWC never relies on RCNLD when valuing a utility for purchase

The City suggests that the ultimate shortcoming in the credibility of IAWC’s RCNLD valuation is confirmed by IAWC’s own testimony. Several IAWC witnesses acknowledged that IAWC does not perform RCNLD analyses to value a utility when IAWC is a willing buyer negotiating with a willing seller in utility acquisitions. [Tr., pp. 755, 757, 889, 975.] The City notes that IAWC’s discovery responses went even further, admitting that neither IAWC nor its parent company, AWWC, utilize the RCNLD appraisal methodology when determining the value of a water utility. [Pekin Ex. 8.0, p. 3.]

The City’s contends that its expert made clear why neither IAWC nor a municipality would use an RCNLD approach as a willing buyer:

A willing hypothetical private buyer would rarely, if ever, pay RCNLD for a regulated utility since it is highly unlikely it could include the full investment in rate base. Further, a municipality would never pay RCNLD because the resulting rate impact on customers would be significant.

[Pekin Ex. 17.0, p. 6.]

As the record further demonstrated, Mr. Reithmiller's and Mr. Reilly's RCNLD valuation must be questioned:

Further, one must question the results of the RCNLD presented by Mr. Reilly when compared to the RCNLD analysis that was performed by Illinois-American in 1997 and updated in 1999 that estimated the value of RCNLD at between \$34 million and \$40 million (other values calculated in this study ranged between \$17 million and \$19 million) (Hals Surrebuttal Attachment 3). Although Illinois-American has tried to say that this was not an RCNLD analysis, Mr. Ruckman called it an RCNLD analysis, and it was labeled as an RCNLD analysis in the report itself. I would agree that the 1999 RCNLD analysis uses a different methodology than used to establish the value advocated by Mr. Reilly, but the 1999 RCNLD analysis points out the fact that it is not unreasonable that a different engineer may come up with a value much closer to \$34 million, and thus a totally different RCNLD analysis than relied upon by Mr. Reilly.

[Id., pp. 10-11.]

e. City acquisition will provide local control, management and oversight

The City contends that water is an important factor in any development decision. [Pekin Ex. 1.1, p. 2.] By controlling this important asset, the City believes IAWC has the ability to control development within the Pekin community without being accountable to the residents of that community. According to the City, acquisition of the Pekin District will shift accountability and control of this important resource to the local representatives of the community.

The City explains that the importance of local control and coordination was highlighted in the Water Task Force Report and the testimony in this proceeding. [Tr., p. 173.] For example, the Water Task Force noted historical problems with the coordination of utility work. [Id.; Pekin Ex. 1.1, pp. 2-3.] In addition, the City Manager described additional historical coordination problems involving "recently resurfaced roads within the City that were then dug up within weeks of the completed resurfacing, so that Illinois-American could do its own capital improvements on pipes." [Pekin Ex. 1.0, p. 13.] The City contends that, under City ownership, integrated planning for infrastructure, roads, sewers, and water will coexist, providing the City the flexibility to plan and act without the inclusion of a not-always-cooperative IAWC. [Pekin Am Ex. 7.0,

p. 11.] The City highlights that Staff recognized this integrated planning of infrastructure as one public interest advantage of City acquisition. [Staff Ex. 1.0, p. 12.]

The City maintains that City acquisition of the system would also give local leaders the benefit of being able to work and negotiate directly with developers on issues of continued growth and development. [Pekin Ex. 1.0, pp. 9-10; Pekin Am Ex. 7.0, p. 10; Pekin Am. Ex. 2.0, pp. 12-13.] The City suggests that there have been historical problems with IAWC in attempting to attract and work with developments around the City. [Pekin Ex. 1.0, pp. 9-10.] For example, the City points to the Water Task Force Report's notations of instances in which development was delayed or expenses increased for the City because of IAWC's disagreement with the developer or company. [Pekin Ex. 1.1, p. 2.] The City points out that this advantage of City acquisition was specifically referenced by Staff witness Johnson:

There are advantages to being able to negotiate with developers and large industrial customers from what may be termed a 'holistic' perspective. For example, a municipality could offer tax incentives, property incentives and utility service rates without the inclusion of a third party (i.e., public utility). It could also guarantee timelines to with the negotiations.

[Staff Ex. 1.0, p. 12.]

Former Pekin Mayor Tebben described the developmental benefits of municipal acquisition in his testimony:

It will be the City Council that can decide when and where improvements are made, without having to negotiate, wait, cajole, and attempt to coerce a distant corporate hierarchy to look out for Pekin's best interests and move at Pekin's pace. It will aid in the coordination of Pekin's comprehensive plan for community growth, especially economic development, as well as public works, street and sewer.

* * *

In this area, we have been the victim of distant indifference to our conditions. That, I would have guaranteed you, would have changed with City ownership

[Pekin Am. Ex. 4.0, p. 5.]

As recognized by the City Manager, "even though the problem has improved somewhat, we have no assurance that it will remain at an acceptable level." [Pekin, Ex. 1.0, p. 13.] The risk that historical problems will return is eliminated if the accountability for, and control of, the system is shifted to the local representatives of the Pekin community. Thus, the City contends that the public interest will be served by the local control, management and oversight made available through City acquisition.

f. Extraterritorial customers will benefit from City acquisition

The City contends that all the evidence presented in this proceeding shows that extraterritorial customers (i.e., people living within the Pekin District service territory but outside the City's limits) will continue to be treated just as they have been in the past, without discrimination. [Id., p. 12.] As summarized by the City Manager, extraterritorial customers "will pay the same rates and have the same access. In addition, problems and complaints will be handled in the same manner as those existing customers lying within the City." [Id.] The City asserts that IAWC was unable to present any evidence that extraterritorial customers will be discriminated against if the City is permitted to acquire the Pekin District.

The City asserts that the rate freeze included in the City Council's resolutions would apply to all current customers of the system, as recently reiterated by the current City Council. [Pekin Ex. 15.1.] According to the City, this commitment has never varied despite elections and turnover within City Council. [Pekin Ex. 15.0, p. 11.] According to the City, residency will not be an issue. [Tr., p. 209.] Importantly, the City points to Staff's testimony that it has no reason not to take the City at its word on this issue. [Id., pp. 75-76, 79-80.] In fact, the City notes that Staff witness Johnson specifically testified that there is nothing in the record that indicates or causes him to believe the City might or would discriminate against extraterritorial customers. [Id., p. 82-83.]

The City classifies IAWC's speculation that the City might condition water extensions for future developments upon annexation is insufficient to demonstrate discrimination. While IAWC relies on speculative annexation statements to support its argument, according to the City, the only evidence in the record indicates that all the annexations in recent history are voluntary ones, with developers wanting to come into the City for services. [Id., p. 213; Pekin Ex. 1.0, p. 11-12.]

The City also maintains that just as there is no record support for IAWC's implication that the City will discriminate against extraterritorial customers, there is also no economic support for this contention. The City notes that extraterritorial customers constitute less than 10% of the total Pekin District customer base. [Pekin Ex. 17.0, p. 15.] Thus, the City provided evidence that, "[b]ased on RFC's rate setting experience, it would not be worth the City's time or money to try to set a rate differential between outside and inside City customers to generate additional revenues since outside City customers constitute such a small portion of the customer base." [Id., pp. 15-16.]

The City contends that the notion of possible unjust treatment of extraterritorial residents is also rebuffed by evidence that emphasizes that the extraterritorial customers of the Pekin District are not an isolated group without influence within the City. According to the City, the Pekin "community" includes the people inside and outside the City's limits. [Pekin Am. Ex. 7.0, pp. 1-2.] The City notes that the extraterritorial areas within the system are often nearly surrounded by portions of the City and that these are not isolated "islands." [Id., p. 2.] The City also contends that many of the persons living

in the Pekin District's service areas that are technically outside of the City's limits are business owners in the City and have significant influence within the City. [*Id.*, pp. 2-3.]

The City maintains that Fernway, which is relied upon by IAWC, is distinguishable. According to the City, the Commission noted in Fernway that the petitioning district consisted of 226 acres and included 338 water customers, while the extraterritorial area of concern contained 600 acres and 100 water customers. *See Fernway*, ICC Case No. 52024, at 2. The percentage of affected extraterritorial customers in Fernway was 22.8%, almost triple the percentage of extraterritorial customers in Pekin (8.8%). The City also points out that the Commission emphasized in Fernway that the Village constituted more than 70% of the area involved and had the most potential for growth in population. *Id.* at 8. The City stresses that neither of these facts is present in this case.

The City argues that extraterritorial customers will receive significant benefits from City acquisition. The City emphasizes that Staff recognizes several benefits of City acquisition that would apply to all customers of the Pekin District, irrespective of where the customer lives. The City notes the following advantages recognized by Staff: the income tax exemption, ability to pursue funding sources unavailable to private enterprise, no rate of return on capital, direct negotiations with developers and large industrial customers, integrated and flexible infrastructure planning, direct resolution of maintenance concerns, fire prioritization, and the proposed five-year rate freeze. [Staff Ex. 1.00, pp. 16-17; Tr., pp. 72-73, 75-76, 91-92.]

The City further argues that Staff witness Johnson's concern about the lack of guarantee of protection against discrimination ignores protections under the common law available through judicial review. *See, e.g., Inland Real Estate v. Village of Palatine*, 107 Ill. App. 3d 279 (Ill. Ct. App. 1982). The court in Inland Real Estate was faced with a similar argument that review of rates by the Commission is required to protect the rights of certain consumers where those consumers did not have a vote because they were not residents of a municipality. In that case, the court noted:

We note, however, "that the inability of the consumer to vote municipal officials in or out of office does not leave the consumer without a remedy, because the reasonableness of their rates is subject to judicial review." (*Conner v. City of Elmhurst* (1963), 28 Ill2d 221, 190 N.E.2d 760; *Village of Niles v. City of Chicago* (1980), 82 Ill. App. 3d 60, 37 Ill. Dec. 142, 401 N.E.2d 1235; *Austin View Civic Association v. City of Palos Heights* (1980), 85 Ill. App.3d 89, 40 Ill. Dec. 164, 405 N.E.2d 1256) As the Supreme Court elaborated in Springfield:

"Municipal officers under the Municipal Ownership act cannot discriminate in rates or make exorbitant and unjust rates to consumers if they discharge their duties faithfully, honestly and efficiently under the act. All their rates and charges fixed by ordinances or resolutions are subject to review by the courts to a like extent as the rates fixed by the Public Utilities Commission for public utilities privately owned, although the

matter of review may be had under a different law and by a different remedy.” 292 Ill. 236, 253, 125 N.E. 739, 739, 746, *aff’d* (1921), 257 U.S. 66, 42 S. Ct. 24, 66 L.Ed. 131.

The Courts are in agreement that municipalities selling water to non-residents do so in their proprietary rather than their governmental capacity and, in so doing, are subject – as are privately owned utilities – to the rule that utility rates must not be unreasonable or discriminatory. (*Conner v. City of Elmhurst* (1963), 28 Ill.2d 221, 190 N.E.2d 760; *Amalgamated Trust and Saving Bank v. Village of Glenview* (1981), 98 Ill. App. 3d 254, 53 Ill. Dec. 426, 423 N.E.2d 1230; *Village of Niles v. City of Chicago* (1980), 82 Ill. App. 3d 60, 37 Ill. Dec. 142, 401 N.E.2d 1235.) As stated in *Austin View Civic Association v. City of Palos Heights* (1980), 85 Ill. App. 3d 89, 94-95, 40 Ill. Dec. 164, 170, 405 N.E.2d 1256, 1262:

“When a municipal corporation owns and operates a water system for the purpose of selling water to consumers, it is acting in a business capacity and is generally to be treated as if it were a private utility company. (Citations) * * * At common law, such as enterprise, because it had a monopoly on the service provided in the area, was prohibited from charging exorbitant rates and was required to serve all of its consumers without unreasonable discrimination in rates or manner of service. (Citations) Today, private utility companies are prevented from charging exorbitant rates or from engaging in unreasonable discrimination in rates or manner of service by statute, and are no longer subject to the common law. (Citation.) Though there is no statute that prevents municipal corporations that operate public utilities from acting in an unreasonably discriminatory manner, there is still the common law duty that prevents them from doing so.”

107 Ill. App. 3d at 282-283.

The City further emphasizes that despite Staff witness Johnson’s guarantee concerns, he continued to endorse all other advantages of the Pekin District acquisition in his rebuttal testimony and in his testimony at the hearing. [Tr., pp. 91-92.]

g. City acquisition will not impact the water rates of IAWC’s other rate areas

The City asserts that acquisition by the City can be accomplished without having a negative impact on the water rates of IAWC’s other rate areas. As explained by the City, IAWC has a unified rate in Illinois, but has excluded the Pekin District from that unified rate because of the less expensive methods needed to supply water to the Pekin District customers. [Pekin Ex. 1.1, p. 3.] Ms. Hals testified that:

Since the Pekin District has its own stand-alone rate, the only costs that would impact other customers of Illinois-American would be the common

costs of the entire system. Since Pekin's operating revenues constitute only 3.40% based on its present rates (or 2.94% based on its proposed rates) as compared to the total Illinois-American operating revenues, the net impact on other customers should be immaterial.

[Pekin Ex. 17.0, pp. 20-21.]

h. Environmental issues related to the City's wastewater facility are outside the scope of this proceeding and are unsupported by the record

The City asserts that the general purpose and duty of the Commission is to ensure that efficient and adequate utility service is provided to the general public at reasonable rates. See, e.g., Commonwealth Edison Co. v. Illinois Commerce Commission, 538 N.E.2d 213, 216 (Ill. Ct. App. 1989) (citations omitted). The City contends that the environmental issues relating to the wastewater system raised by IAWC are not within the particular expertise of the Commission. See, e.g., id. Instead, the City suggests that the Commission must evaluate the City's proposed acquisition of the Pekin District based on a public utility service context and cannot base its decision on an environmental impact context. See, e.g., id. at 219.

The City notes that the Illinois Court of Appeals reversed a Commission decision under Section 7-102 of the Public Utilities Act that relied upon environmental concerns when evaluating the public convenience of a proposed sale of utility assets. In Commonwealth Edison Co. the Court noted:

It is apparent from the record that the Commission attempted to determine whether the proposed sale would benefit the general public. However, the Commission did not examine the sale in a public utility service context, but, instead, in an environmental impact context. This was beyond its authority and was therefore improper.

[id.]

Even if these matters were properly before the Commission, however, the City contends that IAWC's arguments are exaggerated. For example, the City notes that IAWC places significant emphasis on the alleged sanitary sewer overflow ("SSO"). The City maintains it has made numerous efforts to work with the Illinois Environmental Protection Agency ("IEPA") to investigate whether the alleged SSO exists. [Pekin Ex. 6.0, p. 5.] The City notes that IEPA and the City conducted joint visual inspections of the manholes. [id.] The City states that the system was televised in the area of the suspected overflow. [id.; Tr., p. 311.] The City also indicates that it conducted dye water testing. [id., pp. 266-267.] Despite this testing, neither IEPA nor the City has confirmed that an SSO in fact exists. [Pekin Ex. 6.0, p. 5.] Furthermore, the City points to Mr. Kief's testimony, which illustrates that additional plugging, cleaning, and televising of the sewer system was scheduled to proceed. [Tr., p. 278; Pekin Ex. 6.0, p. 5.] The City further asserts that, given the testing that has occurred without any SSO being

proven, there is no record support for IAWC to opine as to the extent or effect of any such SSO. [Pekin Ex. 12.0, p. 12.]

In further support of its position that the wastewater facility demonstrates the City's administrative capabilities, the City cites evidence that the City has undertaken, and continues to undertake, steps to address and improve the wastewater system. The City notes that it performed significant expansions and extensions to the wastewater system, adding at least five miles of trunk lines to the system and upgrading all the lift stations. [Pekin Am. Ex. 2.0, p. 10.] The City also explains that it purchased and installed generators at each lift station to assist in crisis management. [*Id.*] The City also notes that it completely replaced a bar screen facility to address concerns previously raised by IEPA. [Tr., p. 316.] In addition, the City emphasizes that over the last five to ten years, the City has spent millions of dollars to eliminate sewer back-up problems identified by IEPA. [Tr., pp. 264-265.]

Although IAWC critiques the scope of the testimony filed by the City's environmental expert, Dr. Adams, the City notes that Dr. Adams properly limited his review to "the process capability of running a wastewater treatment facility and translating that confidence level to a drinking water system." [Tr., p. 580.] As Dr. Adams testified, such a limitation was appropriate because "operations at the City's wastewater treatment plant No. 1 would be the most relevant to the City's ability to assume operations of the water supply because, from an operational perspective, that represents the type of processes and management that would most directly relate to a water system." [Pekin Ex. 12.0, p. 10.] Dr. Adams testified that the City has more than satisfactorily demonstrated its administrative abilities at the wastewater treatment facility.

Contrary to IAWC's implications, the City notes that "meeting the effluent and providing a clean water back to the Illinois River is [the City's] primary concern." [Tr., p. 294.] To that end, the City notes that it maintains constant lines of communication regarding the operation of the wastewater facility, including daily contact with the wastewater facility's operator and at least monthly contact with IEPA. [*Id.*, p. 375.] If problems are identified, there is an open dialogue to explain or correct the situation.

The City concludes that the wastewater treatment facility has had only "the usual amount of compliance issues over the years," and submits that is simply a part of operating a wastewater treatment system. [Pekin Am. Ex. 2.0, p. 9; Tr., p. 260 ("We comply with the terms of [the NPDES] permit, but again, like probably most, if not all, systems we have had some excursions from the permitting").] The City notes that the wastewater facility infrastructure is typical of other river communities in the area, which also experience occasional excursions during severe storm events without the fault of the facilities or their administrators. [*Id.*, pp. 306-307.] This is also supported by the Staff's testimony that the deficiencies raised with regard to the wastewater facility do not necessarily mean that the wastewater system is operated improperly, but instead that improvements are often necessary to meet IEPA regulations. [Staff Ex. 3.0, p. 4.]

i. The Pekin District is not a complex system

The Pekin district is supplied by ground water. IAWC's President testified that "river water treatment is typically more complex" as compared to ground water supply. [Tr., p. 750.] During cross examination, IAWC's President was asked to compare the Pekin District to several other systems in Illinois and testified that the Pekin District was "less complex" than all but one. [Id., pp. 750-751.] According to the City, the undisputed fact is the Pekin District is less complicated as compared to most systems because of the easy access to, and the high quality of, the water in the aquifer. [Id.] The City notes that the water is pumped from fairly shallow wells, and needs only minimal treatment before being delivered into the system for consumption. [Pekin Ex. 1.0, p. 3; Pekin Am. Ex. 2.0, p. 3.] As such, the City asserts that its assertion that the Pekin District is not complex is well supported.

j. The City is best equipped to handle IAWC's projected "conditions in the water industry"

The City argues that IAWC cannot support its continued ownership of the Pekin District based on "future challenges" facing the water industry. Even a cursory review of IAWC's assertions emphasize that the concerns raised by IAWC are national in scope and raise nothing specific to the Pekin District. More important, IAWC's alarmist arguments lose all credibility given the limited capital improvement forecasts presented by IAWC in this proceeding. [Pekin Ex. 8.0, pp. 16-19.] The City asserts that these limited capital improvement projections do not support the excessive infrastructure costs warned against by IAWC.

Even if the concerns in the report highlighted by IAWC turn out to be correct, however, the City asserts that it will best be able to address these needs. The future capital needs of the Pekin District can be met more cost effectively with City ownership since a municipality enjoys a lower cost of capital. [Pekin Ex. 8.0, p. 23.]

The City argues that it has demonstrated its ability to financially address any future "conditions in the water industry. The City worked with the IEPA to put together a groundwater protection ordinance for the wells used by IAWC to provide water to the Pekin District. This ordinance was reviewed by the IEPA, presented to City Council and adopted. (Pekin Am.Ex. 2.0, p. 4). Through this ordinance, the City controls development in the sensitive recharge and setback areas for the wells serving the Pekin District. (Id., pp. 4-5) This groundwater protection plan has been acknowledged nationally and recognized as a Groundwater Guardian for eight consecutive years. (Id., p. 4.; Pekin Ex. 6.0, p. 6.) The City asks the Commission to reject IAWC's assertion that "future challenges" facing the water industry support IAWC's continued ownership of the Pekin District.

3. The City's plan to hire a reputable contract operator is well documented

The City maintains there is ample evidence that it will hire a competent contract operator upon acquisition of the Pekin District, and suggests there is no record support for IAWC's challenges to this assertion. The City relies on the fact that several City witnesses testified that the City will hire a reputable contract operator to run the system once it is assured of acquisition of the Pekin District. [Pekin Am. Ex. 7.0, p. 5; Tr., pp. 383-384.] The City also notes Staff testimony that if the City contracts with a professional certified contractor (whether it be United Water, U.S. Filter or IAWC), as is the City's plan, City ownership could serve the public interest just as well as IAWC's continued ownership. [Tr., p. 77.]

The City maintains that it is premature for the City to select the actual contract operator that will run the system at this early stage of the condemnation proceedings. [Pekin Ex. 17.0, p. 19; Tr., pp. 194-195, 383-384.] The City notes that acquisition is still several years away and any operator selected at this point in time may not be in existence when the acquisition eventually occurs due to the volatile nature of the water industry and the pace of corporate mergers and acquisitions, as evidenced by IAWC's recent history. Conversely, the City also maintains that there may be better operators available at that time that the City will not be able to consider if it is required to select an operator now.

Even the President of IAWC suggested that an RFP may be unnecessary at this stage of the condemnation proceeding. [*Id.*, p. 746.] To further support its position that it is premature to select an operator, the City points to the testimony filed by the City Manager:

As a practical matter, Illinois-American and its owners have delayed the Peoria acquisition by five years, even though they have a clear franchise obligation to sell. Given the amount of money, over \$1,500,000 spent to fight the referendum in Pekin, and the resources they are devoting to this proceeding, the City can expect an appeal of the decision from the I.C.C., as well as a long and arduous fight in Circuit Court in condemnation, with appeals from that. With that kind of delay, it is not prudent for the City to commit large amounts of time and money on plans that will certainly change over a period of years. Illinois-American openly admits that they change the plan each year, as does the City with our capital plan. Similarly foolish is their criticism of the City for not choosing a contract operator years before we have ownership, or at least ownership is certain within a definite time frame. The RFPs will be developed once it makes sense to develop them. The question isn't whether we have developed an RFP, but whether we have the expertise, experience and talent to do the job right. We do, as we have demonstrated.

[Pekin Ex. 15.0, p. 3.]

The City submits this will always be the case and that requiring a formal RFP prior to Commission approval will inevitably lead to requests such as this one being denied, thereby eviscerating the authority granted by the legislature.

The City notes that it can continue to enjoy all of the benefits, efficiencies, and expertise of a seasoned water operator by hiring a reputable contract operator. [Pekin Ex. 17.0, p. 25.] Both IAWC's President and Vice President of Engineering recognized that IAWC could be the contract operator for the System, and – if that were to happen – the full panoply of IAWC resources would still be available to Pekin District as a stand-alone system. [Tr., pp. 722-725; p. 970.] The City also points to Staff's witness Johnson's testimony, which recognizes that the City would "ensure that professional certified operators maintain the integrity of the system." [Staff Ex. 1.0, p. 9.]

4. The City has the power to proceed with this condemnation

The City maintains it has the legal authority to proceed with the condemnation of the Pekin District system. The City contends that IAWC's assertions to the contrary, which were first raised in its post-hearing briefing, are untimely and incorrect. The City believes it has both the general power to acquire property outside of its boundaries and, by legislative grant, the eminent domain power to acquire the Pekin District in its entirety.

The City notes that a municipality generally has the power to acquire property outside of its corporate limits. See, e.g., People ex rel. City of Salem v. McMackin, 53 Ill.2d 347, 365 (Ill. 1972). More specifically, the City maintains that Division 130 of the Municipal Code permits a municipality to purchase a waterworks system in its entirety. The City notes that Section 11-130-1 provides that "any municipality may purchase or construct waterworks or construct improvements to its waterworks as provided in this Division 130." 65 ILCS 5/11-130-1. Section 11-130-2 then defines the term "waterworks": "The term 'waterworks', as used in this Division 130, means and includes "a waterworks system in its entirety or any integral part thereof, including mains, hydrants, meters, valves, stand pipes, storage tanks, pumping tanks, intakes, wells, impounding reservoirs, or purification plants." 65 ILCS 5/11-130-2. Therefore, the City concludes that Division 130 provides a municipality with broad powers to acquire an entire waterworks system, such as the Pekin District.

The City also asserts that the legislature granted municipalities the right of eminent domain to exercise Division 130's broad acquisition powers. The City points the Commission to Section 11-130-9, which provides "For the purpose of purchasing any waterworks under this Division 130, or for the purpose of purchasing any property necessary therefore, the municipality has the right of eminent domain as provided by Article VII of the Code of Civil Procedure, as heretofore and hereafter amended." 65 ILCS 5/11-130-9. The City claims that it therefore has the power to use eminent domain to acquire an entire waterworks system (and any property necessary therefor), even if a part of that system may be outside of its corporate boundaries.

The City asserts that IAWC's attempted reliance on Division 117 to suggest the City lacks the requisite authority misses the point, and notes that Division 117 is inapposite. The City emphasizes that it has proceeded under Division 130 from the outset. [Petition, ¶ 3.] The City also suggests that IAWC's attempted reliance on only selected portions of Section 11-117-4 of Division 117 is misplaced. By omitting the bulk of this section, the City contends that IAWC cites it in a very misleading way. When read in its entirety, the City submits that Section 11-117-4 is far different than anything found in Division 130. Further, the City again emphasizes that it does not rely on Division 117 in this proceeding, but rather relies on Section 11-130-9, which authorizes a broader right allowing a municipality to condemn an entire waterworks system.

The City rejects IAWC's implication that the Commission's decision in Fernway Sanitary District v. Citizens Utility Company of Illinois, July 10, 1968 Order, Case No. 52024 (ICC 1968), somehow supports IAWC's contention that the City lacks the authority to condemn property outside of its boundaries. The City maintains that this implication is not supported by the Commission's actual Order in Fernway. First, the City declares that Fernway, like Division 117 and the City's home rule powers, has nothing to do with the eminent domain powers granted in Division 130. Second, the City notes that the Commission specifically recognized that the relevant statute in Fernway gave the petitioner the right to condemn property "either within or without its corporate limits" if consistent with the corporate purposes established upon creation of the Fernway District. See id., p. 5. The City argues that the Commission's holding in Fernway was based entirely on the petitioner's self-limiting corporate charter, which restricted the petitioner to supplying services exclusively to the citizens located within its boundaries. See id. The City emphasizes that no such relevant restrictions exist here.

The City asserts that the only authority IAWC cites relating directly to Division 130 is Village of Bolingbrook v. Citizens Utility Co., 267 Ill. App.3d 358 (Ill. Ct. App. 1994). According to the City, IAWC attempts to rely on this case as construing Division 130 strictly against a municipality seeking to condemn a waterworks. However, the City notes that in Village of Bolingbrook, the issue being "strictly construed" was not whether extraterritorial property could be acquired by a municipality, but rather whether the municipality could proceed with an eminent domain action without first receiving Commission approval. The City emphasizes that the court specifically stated, "Since we find that the issue of ICC approval is determinative of the outcome of this case, we will confine our discussion to that issue alone." Id. at 359.

Finally, the City argues that "[a] primary rule of statutory construction is that a court must give the language of the statute its plain and ordinary meaning." Id. (citation omitted). Division 130 grants the authority to use eminent domain to acquire "a waterworks system in its entirety." See 65 ILCS 5/11-130-2; 5/11-130-9. Any argument to the contrary ignores the plain and ordinary meaning of Division 130. The City submits that IAWC's proposed interpretation would read the right of eminent domain completely out of Division 130, despite the legislature's specific grant in 65 ILCS 5/11-130-9, except in the rare instance where a municipality shares the identical geographic footprint of a waterworks company. As such, the City contends that IAWC's assertions that the City

lacks the necessary authority to proceed with this condemnation are untimely, unsupported and against the plain and ordinary meaning of Division 130.

B. Illinois-American's Position

1. City Ownership and the Public Interest

a. The City's Argument that City Ownership will Better Serve the Public Interest of Customers

Illinois-American points out that the Commission must take into account the effect the condemnation will have on all customers of Illinois-American, including the approximately 1,200 current Pekin District customers who reside outside the City limits and its customers in other areas of the state. [ICC Staff Ex. 1.0, p. 17; IAWC Ex. 11.0R, p. 7; Pet., ¶ 8.] IAWC notes that, after reviewing all of the direct evidence, Staff witness Johnson recommended in rebuttal testimony that the City's petition be denied because the City had failed to adequately address the concern regarding possible discrimination against non-residents in rates and service. [ICC Staff Ex. 3.0, pp. 5-7.]

According to IAWC, all customers within the Pekin District are subject to the same rates, rules, regulations and conditions of service regardless of whether they reside within the City's municipal boundaries. IAWC's obligation to provide service on a non-discriminatory basis is codified by statute (220 ILCS 5/8-101), and is enforced by Commission supervision. Consistent with this obligation, IAWC maintains that the Pekin District system is designed and operated on a regional basis, without any recognition of municipal boundaries. IAWC provides service at the same rates to both City residents and non-residents.

Illinois-American notes that, as Staff witness Johnson stated when he submitted his rebuttal testimony, the City had not made an effort to pass a resolution, ordinance or anything else guaranteeing the protection of customers who reside outside the City. Following the filing of Staff witness Johnson's rebuttal testimony, the City Council did in fact pass a new resolution, Resolution No. 5, on May 5, 2003. However, as stated by Staff witness Johnson, Resolution No. 5 does nothing to assuage his concerns because "there is really nothing said in there about the protection of customers outside the city." [Tr. 88-89.] Moreover, IAWC asserts that, even if the City passed a resolution or ordinance stating that the City will not discriminate against non-residents, the City Council could amend that ordinance at any time to change the treatment of customers who are outside the City limits and have no vote. The City's finance director, Mr. Reis, admitted that elected City officials change every four years, and that the City's policies have indeed changed from time to time in the past.

IAWC asserts that the testimony and affidavit submitted by City Manager Hierstein reveal that the City proposes to continue its past practice of discrimination against non-residents should the City acquire the water system. Mr. Hierstein states both in his direct testimony and in the affidavit he submitted in support of the City's petition that the City may refuse an extension of service to new water customers unless

those customers consent to be annexed into the City. [Hierstein Aff. to Pet., ¶ 19; Pekin Ex. 1.0 p. 11.] Also, IAWC points out that City Public Works Director Kief testified that it is the City's practice to refuse sewer service to non-residents unless those non-residents first petition to be annexed into the City. [Tr. 224-25.]

IAWC notes that the City's Water Study Task Force Report points to the Galesburg, Illinois water system as an example of how rates can be lowered in Pekin. As IAWC points out, however, the system in Galesburg is not the same as Pekin's (thus, the costs of service are different), and the City of Galesburg charges its non-resident customers a rate which is double that paid by residents of the City. In fact, Mr. Hierstein admitted that at no time during the year-long study the Task Force conducted was any inquiry made into how the non-resident customers in Galesburg were treated, or how non-residents would be treated within the Pekin District. [Pekin Ex. 1.0, p. 5; Tr. 186.] Mr. Hierstein also conducted several rate comparisons of his own, in addition to the Galesburg analysis, contained in the Water Study Task Force Report. Mr. Hierstein admitted that he did not make any inquiry into how non-residents were treated when making those comparisons because, in his opinion, non-residents in most cities have a "negligible impact." As IAWC points out, however, without information about non-resident rates the City's rate comparisons are meaningless. In addition, Mr. Hierstein admitted on cross-examination that the number of non-residents served by the Pekin District system makes the issue "more significant" than in other cities.

IAWC maintains that the Brush Hill fire protection contract cited by the City as an example of how the City currently treats non-residents in a nondiscriminatory manner provides even more insight into the prospects of non-residents in the event that the water system were to be acquired by the City. Mr. Hierstein admitted that the contract negotiated with Brush Hill provides expressly that the City can refuse to provide emergency or fire services to Brush Hill, if doing so would interfere with the fire or emergency needs of City residents. [Tr. 161-68.] According to IAWC, the Brush Hill contract is discriminatory - it places the needs of the residents above those of the non-residents, which is precisely what is likely to happen in regard to water service if the City acquires the water system.

In addition to non-resident customers of the Pekin District, IAWC maintains that the City's proposal also leaves unprotected all customers in Illinois-American's service areas that are not a part of the Pekin District. According to Mr. Ruckman's testimony, if the City were to acquire the Pekin District system, the remaining customers of Illinois-American would face higher rates, as there would be fewer customers to cover fixed administration costs. [IAWC Ex. 2.0, p.12.]

b. The City's Management and Operation of its Wastewater System

IAWC notes that the City points to its wastewater system to demonstrate its competence to handle operation of a water company. According to Dennis Kief, the City's Public Works Director, "...the City's track record in dealing with the Wastewater Treatment System is a solid basis upon which I can see nothing but positives for the

public and the customers of the Pekin System, if the City acquires it." [Pekin Ex. 2.0, p. 12.]

IAWC asserts that, in light of the actual history and condition of the wastewater system, the City's reference to it as being the "solid basis" for acquisition of the water system is nothing short of remarkable. An examination of the wastewater system reveals widespread problems and a history of chronic noncompliance with the requirements and directives of the Illinois Environmental Protection Agency ("IEPA"). These problems range from an inability to properly treat wastewater before dumping it into the Illinois River (or, for that matter, to provide any treatment at all), to inadequately addressing the issue of a suspected sewer overflow that the IEPA first brought to the City's attention almost ten years ago. Illinois-American asserts that the City's problems with its wastewater system raise significant doubt about the City's ability to properly operate the Pekin District water system.

The City's problems with its wastewater system were addressed by IAWC's expert witness, Yvonne Ciccone. The City waived its right to cross-examine Ms. Ciccone. According to Illinois-American, in her direct testimony [IAWC Ex. 8.0], Ms. Ciccone discussed in detail the operational breakdowns within wastewater treatment plant 1 ("WTP 1"), suspected squandering of funds by the premature shut down of wastewater treatment plant 2 ("WTP 2"), and the City's chronic and ongoing inability to comply with all applicable IEPA regulations. IAWC notes that one of the more disturbing issues that was uncovered by Ms. Ciccone is the City's continued inability or unwillingness to locate the suspected sanitary sewer overflow ("SSO") identified by IEPA.

IAWC points out that this SSO could potentially be dumping thousands of gallons of raw sewage directly into the river. According to IAWC, this is not a recent problem, as the IEPA has repeatedly warned the City about this problem for almost ten years. Despite a high level of concern on behalf of the IEPA, IAWC points out that the City has never taken the necessary steps to determine the location of the SSO. According to IAWC, the City is purportedly attempting to find a company to find and fix the SSO, but, even with the passage of ten years, this still has not occurred. [Pekin Ex. 6.0, p. 5; Tr. 278.]

IAWC asserts that the City's unwillingness to aggressively pursue and locate the SSO is indicative of the low standards to which the City holds its wastewater system. For example, Mr. Kief stated at trial that he would be happy with four or five excursions at the wastewater treatment plant each year. [Tr. 307.] When questioned about the numerous wastewater system excursions during the last three years, Mr. Kief retracted the statement he made in his direct testimony that the City "is in compliance with US and Illinois EPA regulations." [Pekin Ex. 2.0, p. 9.] Instead of full compliance, Mr. Kief stated at the hearing that what he actually meant is that they were "generally in compliance." [Tr. 260.] As testified to by Terry Gloriod, the President of IAWC, such low standards are not acceptable to IAWC. As Mr. Gloriod stated, almost in compliance with mandatory state and federal regulations is insufficient when it comes to providing safe drinking water. [Tr. 731.]

According to IAWC, the City's expert, Dr. Carl Adams, did not adequately address the issues raised by Ms. Ciccone. IAWC notes that the premise of Dr. Adams' testimony, that the City can manage and operate the Pekin District system due to its experience with the wastewater system, is faulty as Dr. Adams has virtually no experience whatsoever with water systems. According to Dr. Adams, his background is in wastewater and he does not consider himself an expert on the subject of drinking water regulations. [Tr. 559-60.] As IAWC points out, this admitted lack of experience, however, did not stop Dr. Adams from testifying at length with regard to the Pekin District water system. As Dr. Adams admitted at hearing, his lack of knowledge concerning water systems prompted him to rely on the views of two other individuals not called as witnesses, Robin Garibay and Sam Shelby – a fact not disclosed to the Commission in Dr. Adams' filed testimony. [Tr. 570.]

IAWC indicates that Dr. Adams never inspected the Pekin District water system, and when asked about the water system, it was obvious that he had only a limited familiarity. Dr. Adams' testimony that the Pekin District system is not a "complex system" was founded solely on his belief that, in general, ground water systems are simpler than surface water systems. [Tr. 571.] As explained by IAWC witness Johnson, the operation of the Pekin District is actually quite involved given the continuous maintenance and adjustments (including continual calibration and program updates) necessary for proper operation of the Supervisory Control and Data Acquisition ("SCADA") system by highly skilled and trained facility operators, and given the tetrachlorethylene ("PCE") and nitrate pollution of the aquifer serving Pekin necessitating a complex Granular Activated Carbon ("GAC") facility that also requires constant monitoring. [IAWC Ex. 3.00, pp. 19-20.] Since Dr. Adams had neither the background nor the preparation to give an opinion on the Pekin District system, IAWC asserts that his testimony on that subject be disregarded.

IAWC also maintains that Dr. Adams' testimony concerning the wastewater system is too limited in scope. Dr. Adams' testimony does not address the entire wastewater "system." Instead, Dr. Adams specifically limits his testimony to one small portion of Pekin's wastewater system, namely WTP 1. [Tr. 572.] IAWC maintains that, by giving an opinion based upon this narrow slice of the wastewater system, Dr. Adams avoids providing an explanation for the City's failure to adequately handle the suspected SSO and ignores the fact that the City's wastewater system as a whole has been cited by the IEPA for over 15 violations during the past three years.

IAWC also notes that Dr. Adams' testimony concerning WTP 1 contains various errors and misstatements. IAWC maintains that what the City relies on as the "solid basis" for its Petition in this case provides no support at all for the City's position, and in fact shows clearly that the Petition should be denied.

c. Provision of Service Under City Ownership

Illinois-American asserts that the City's criticisms in this proceeding of IAWC's service are suspect. In response to a 2001 performance survey, City Manager Hierstein, Mayor Tebben and Fire Chief Janssen all indicated that they were very

satisfied with IAWC and the service it provides to the Pekin District in virtually every area, including responsiveness, reliability, water quality, accountability, and coordination with the City. IAWC notes Mr. Hierstein's admission that the City placed the acquisition issue before the voters a second time in 2002, not because of service issues or complaints, but because of the proposed stock transfer of IAWC's parent corporation to a foreign company. The City's Water Study Task Force report specifically found that examples of less than perfect service by IAWC are "the exception rather than the rule, as Illinois-American appears to be serious in maintaining high customer satisfaction." [Tr. 173-74.] IAWC notes that the City has never filed a complaint with the Commission about the service issues referenced by its witnesses, and has no letter, memorandum, note, correspondence or any other written document that mentions any such issues.

(i) Small Diameter Mains

The City criticizes IAWC's rate of replacement of what the City contends is an excessive amount of water mains in the Pekin system that are 2 inches in diameter or less. The City contends these small diameter mains provide inadequate pressure and represent a fire safety hazard. [Pekin Exs. 1.0, p. 13; 2.0, p. 3; 4.0, p. 5.] Illinois-American points out, however, that the Pekin District system dates back to 1886. As with most systems of that age, the Pekin system does have small diameter water mains, which IAWC defines as mains with a diameter of 4 inches or less. [Id.] The installation of small diameter water mains continued to increase up until IAWC acquired the system in 1982. According to IAWC, immediately upon acquisition of the system, IAWC began replacement of the small diameter mains. IAWC asserts that, since acquisition of the system, IAWC has replaced approximately 24,000 feet of small diameter mains, which represents an 11% reduction.

IAWC asserts that, in 2001, it established a task force to develop a more formalized method of prioritizing small water main replacement. The task force developed a prioritization model to determine which small diameter mains should be replaced first based on eight characteristics which affect main replacement needs, including the number of leaks, fire flow, main size, age and material, water quality, and number of customers connected to the main segment. IAWC states that it discussed the model with the City of Pekin's officials, including the Mayor, City Manager, Public Works Direct and Assistant City Engineer. According to IAWC, the City provided input, and fully supported use of the model. As a result of the small main replacement program, IAWC has catalogued all of the small diameter mains in the Pekin District system, analyzed the impact each small main segment has on the provision of water, and scheduled those mains for replacement according to need. Based on the results of the small main analyses and consideration of the related rate effect, IAWC has implemented a plan to replace 100% of all water mains 3 inches in diameter or less (or 75% of the mains 4 inches or less) in the Pekin system within 30 years. According to IAWC, this represents a replacement rate of 5,000 feet annually, which is triple the replacement rate of the last 20 years. The estimated cost for this replacement program is approximately \$300,000 per year.

IAWC maintains that, in comparison to IAWC's thorough analysis of the small mains, Pekin has performed no analysis whatsoever. According to IAWC, the City fails to explain how it would approach the small main problem differently from the method IAWC developed, which was specifically approved and accepted by the City's officials, other than to speculate that the City would divert some funds from other "less essential" improvements and use those to replace small mains instead. According to IAWC, the City has performed no study or analysis of system needs, and has no basis whatsoever to determine which needs are "less essential" than small main replacement. The only need the City specifically identifies as "less essential", again without the benefit of study, is replacement of meters. [Pekin Ex. 1.0, p. 22.]

IAWC points out that because the City has not studied the water system needs or operations, it has no basis to conclude that IAWC's meter replacement program should be changed. In this regard, it should be noted that IAWC currently replaces and calibrates older meters as required by Commission rules designed to ensure the accuracy of customer bills, and Staff witness Johnson specifically found that approach to be in the public interest. [IAWC Ex. 3.0, p. 22; ICC Staff Ex. 1.0, pp. 9-10.]

In addition to the exhaustive analysis IAWC conducted in 2002 of the impact of the small diameter mains in the Pekin system as part of its comprehensive planning process, IAWC notes that it also performed a comprehensive assessment, using a computerized hydraulic model, of the entire Pekin distribution system. This assessment included an analysis of available fire flows throughout the system. [IAWC Ex. 3.0, pp. 16-17.] IAWC's investigation indicated that because the Pekin District system is an integrated system, meaning there is no one area with a mass concentration of small diameter water mains, there are no areas in which water pressure or rate of flow is inadequate due to small diameter water mains. [Id., p. 20.]

(ii) Fire Protection Service

Through the testimony of Fire Chief Janssen, the City raised several criticisms of IAWC's involvement in fire protection within the City. Fire Chief Janssen criticized IAWC's performance in the following areas: (1) maintenance and replacement of fire hydrants; (2) painting of fire hydrants; (3) main size; and (4) handling of the alleged problem of gravel in the mains. IAWC maintains that none of Fire Chief Janssen's criticisms are supported by the facts.

Mr. Janssen claims that IAWC fails to maintain operable hydrants. IAWC asserts, however, that the only evidence Mr. Janssen offered in support of this allegation was a reference to a January 5, 2002 fire where he claims the hydrant was inoperable. Mr. Janssen states IAWC did not respond promptly to the fire department notification of the inoperable hydrant, and then did not repair the hydrant for over a month. IAWC points out that, in fact, the hydrant had recently been inspected a few months before the fire and found in good working order, and was frozen, not broken, on the day of the fire. [IAWC Ex. 4.0, pp. 24-25.] IAWC personnel responded to the call from the fire department, thawed the hydrant, and restored it to working order by the Monday following the fire on Friday. [Id.] In rebuttal testimony, Mr. Janssen claimed he did not

know the hydrant was repaired, because IAWC reports repairs to the Tazewell-Pekin Consolidated Communications Center ("TPCCC"), not directly to the fire department. IAWC notes, however, it reports to TPCCC because the fire department specifically requested that it do so. [IAWC Ex. 4.0R, p. 6.]

IAWC states that it conducts annual inspections of each hydrant in the Pekin system, and maintains an aggressive hydrant replacement program to promptly replace outdated or broken hydrants. [IAWC Ex. 4.0, pp. 6-7.] IAWC consults with the fire department to create its list of hydrants that need to be replaced. In 2002, IAWC replaced more than 30 hydrants in locations approved by the fire department. IAWC notes that the City admits that IAWC maintains regular coordination with the fire department on hydrant replacement, and Mr. Janssen specifically acknowledged that IAWC had never refused the City's request for repair or replacement of a hydrant. [IAWC Ex. 4.0, pp. 6-7; Tr. 421-22.]

Mr. Janssen also claimed that fire protection within the City is hampered by the inadequately sized mains. As IAWC points out, however, the only evidence Mr. Janssen offered to support that allegation, other than his recollection of undocumented problems at two fires that supposedly occurred "some years ago" (sometime during the 1980's), was his assertion that the fire department's failure to contain a March 3, 2002 fire at Jim's Automotive was caused by inadequate flow from the hydrants used to fight the fire, which Chief Janssen contends was a direct result of smaller sized mains feeding the hydrants. [Pekin Ex. 3.0, p. 4.] Mr. Janssen admitted, however, that the Fire Department had no records of the amount of pressure available for fighting the fire, and that he had no evidence to support his contention. Furthermore, IAWC notes that the assertion that the hydrants used to fight the fire were connected to small diameter mains is incorrect. According to IAWC, two hydrants used to fight the fire, both of which were less than 3 years old, are served by 6 inch mains. [IAWC Ex. 4.0, pp. 27-28.]

To resolve this matter, IAWC performed a hydraulic analysis which shows that the hydrants used to fight the fire actually produced between 1000 and 1600 gallons per minute at 20 psi, well above national fire protection standards. [IAWC Ex. 4.0, pp. 28-29.] Mr. Janssen himself estimated that the hydrants produced at least 2900 gpm during the fire. [Tr. 435.] Mr. Janssen also admitted that he never contacted IAWC to request that larger mains be installed near the location of the fire. [Id., 433.] In discussing the Jim's Automotive fire, Mr. Janssen also criticized IAWC for not responding quicker to calls during the fire, but later admitted he had been provided with emergency contact numbers for IAWC personnel, but did not have the numbers with him during the fire and so had not called them. [Pekin Ex. 3.0, p. 5; Tr. 422.]

Mr. Janssen also claims that, despite notice and complaint, IAWC has failed to respond to an ongoing problem of gravel in the mains that has existed since the 1980s. [Pekin Ex. 3.0, p. 6.] However, when questioned further about this alleged problem, Mr. Janssen admitted the City had no records or documentation of any such problem, that in fact, there was no evidence that IAWC had been made aware of the perceived problem, and that he personally had made no efforts to complain, either in writing or verbally, about the problem to anyone at IAWC or the Commission. [Tr. 419-21.] As noted

earlier, IAWC conducts a thorough inspection of each hydrant in the Pekin system annually. IAWC also conducts regular inspections of its well pumps. If there were a problem with gravel in the mains for the past decade, IAWC states that it would have been evident in these inspections. [IAWC Ex. 4.0R, pp. 4-5.]

Mr. Janssen also criticized IAWC for painting the fire hydrant bonnets according to main size, as opposed to flow, going so far as to state that he had "no idea why Illinois-American has chosen to essentially ignore NFPA requirements, and go their own way." [Pekin Ex. 3.0, p. 4.] In fact, as Mr. Janssen later admitted, IAWC painted the hydrants according to main size because that is precisely what the fire department requested. [IAWC Ex. 4.0, pp. 8-9.] IAWC provided the fire department with a map of the hydrants, and the fire department color coded the map according to the colors each hydrant should be painted. [Id.]

(iii) IAWC's Cooperation With the City

Mr. Hierstein criticizes IAWC's alleged lack of cooperation in coordinating planning and infrastructure maintenance. [Pekin Ex. 1, pp. 6-7, 13.] For example, he contends that the City resurfaces a road and within weeks IAWC digs it up to perform maintenance on the water mains. Mr. Hierstein further alleges that the City has repeatedly complained to Illinois-American about this "absurd situation." [Id., p.13.]

IAWC notes, however, that in the City's 2001 Comprehensive Plan Update, the City describes its coordination with utilities, including Illinois-American, as "excellent." [IAWC Ex. 4.11.] Moreover, in a February, 2001 letter to IAWC President, Terry Gloriod, Mr. Hierstein himself stated: "I genuinely appreciate the cooperation that Pekin is receiving from you and your Peoria and Pekin management in a variety of issues." [IAWC Ex. 5.2.] And, even after the filing of the Petition, Mr. Hierstein acknowledged in response to a data request that coordination between the Company and the City has been greatly improved over the past years. [IAWC Ex. 5.3.]

Illinois-American notes that it, along with the other utilities, participates in monthly utility coordination meetings conducted by the City. [IAWC Ex. 4.00, p. 9.] At these meetings, information regarding the City's and the utilities' ongoing and planned projects is exchanged. In addition, every day, the Pekin District of Illinois-American e-mails a copy of its daily work schedule to the City engineer. [Id.] Illinois-American also prepares an annual capital improvement plan for the Pekin system, which includes water main replacements and other infrastructure improvements. [Id.] This plan is communicated to the City prior to construction so that any conflicts can be resolved. Finally, the City prepared a five-year street plan, which was provided to Illinois-American in 2001. As explained by Randy West, the Operations Superintendent for IAWC's Pekin District, IAWC makes every effort to schedule capital projects around the City's plan for street repairs. [Id.] Mr. West described two examples of Illinois-American's efforts in this regard. First, in 2002, Illinois-American had two water main replacements scheduled in areas that the City planned street pavement overlays. [Id., p. 11.] Illinois-American and the City worked together so that the water main excavations could be completed before the City's street work was done. Second, Illinois-American agreed to install water main

and road crossings in conjunction with new road construction that the City has now begun on the eastern side of the City. [*Id.*]

(iv) Service Under City Operation

IAWC points out that the City has no plan to assure that customers will be better off under municipal ownership. IAWC asserts that it has a proven record of providing outstanding service at stable rates in Pekin, has conducted a thorough and ongoing analysis of the future needs of the system, and has developed detailed and comprehensive plans to address those needs. [IAWC Ex. 3.0, pp. 5-6, 12-17.] Conversely, the City has made no effort to analyze the needs of the system, or to formulate a specific operating or capital plan. [Tr. 191-98.] According to IAWC, the City has no specification on how it will run the water system, and cannot agree even among its own witnesses how many employees it will require. [Pekin Exs. 1.0, p. 6; 7.0, p. 6; 6.0 p. 4.] The City has no idea what types of capital projects it will undertake or forego, what its operating costs will be, or how non-residents will be treated. [IAWC Ex. 3.0, p. 24; Pekin Ex. 1.0, p. 5; Tr. 186-88.]

The City claims it has demonstrated that it has the expertise to run the water system based on its "exemplary" experience with wastewater operations, which, according to Illinois-American, is not exemplary. IAWC asserts that, not only has Pekin failed to meet its burden of proving that service will improve under City ownership, the evidence presented demonstrates that service will likely decline under City ownership. As stated by IAWC witness Stack, "continued ownership and operation of the Pekin District system by Illinois-American, with oversight by the Commission, is clearly preferable to condemnation by Pekin from a public interest standpoint." [IAWC Ex. 11.0R, p.7.]

IAWC asserts that, through its comprehensive planning process, IAWC regularly conducts detailed analyses of all aspects of the water system, which include the following: (1) development of customer account and demand projections for a 15-year planning period; (2) examination of the adequacy of existing sources of supply and recommended improvements; (3) assessment of treatment facilities in light of existing and proposed water quality regulations, treatment and safety standards; and (4) analysis of water system transmission, distribution and storage needs. [IAWC Ex. 3.0, pp. 5-6, 12-17.] IAWC then uses the results of these analyses to formulate a comprehensive capital and operations plan which is reviewed annually and updated every 5-7 years. [IAWC Ex. 3.0, pp. 6-7]

In contrast to IAWC's detailed analysis and planning process, IAWC maintains that the City's proposal is almost entirely undefined. According to IAWC, Pekin has no specific capital or operating plan. The City also claims it will use IAWC's plan as a starting point, but then make unspecified changes. [Pekin Ex. 7.0, p. 4; IAWC Ex. 1.0R, pp. 2-3.] The City claims it will initially adopt Commission rules governing operations and customer service, while at the same time acknowledging that it intends to: (1) condition extensions of service on annexation; (2) disregard the Commission's rule and policies regarding subsidization of main extensions in the rates of existing customers;

and (3) replace the Commission-prescribed meter replacement program with another completely unspecified schedule for meter replacement. [IAWC Exs. 2.0, p. 15; 3.0R, pp. 8-9; Pekin Ex. 1.0, p. 22.]

The City states that it will hire a contract operator to run both the wastewater and water system. IAWC points out, however, that the City has no idea who that operator will be, has made no effort to identify the minimum performance standards the operator would need to meet, specify the responsibilities the contract operator would have, or described the split and/or overlap of authority to make decisions between the City and the proposed contract operator. [IAWC Ex. 1.0, pp. 22-23.] IAWC maintains that, based on the City's lack of planning, the difficulties encountered by both Pekin and other cities, such as Atlanta, with contract operators, as well as the complex nature of the specification and bid process, there is no basis to know how retention of a contract operator, if one is hired, might affect operation of the water system under City ownership. Based on his investigation, Staff witness Smith concluded that there was "no plan or evidence supporting" the assumption that a contract operator would be hired at all. [Staff Ex. 5.00, p. 4.]

d. Main Extension Policy

An additional reason the City cites in support of its claim that the public interest will be better served through City ownership is the assertion that the acquisition will allow the City to better manage City growth and development. [Pekin Ex. 1.0, p. 9.] Mr. Hierstein alleges that Illinois-American's lack of cooperation hampered both residential and commercial development. [Pekin Ex. 1.0, p. 9.]

Specifically, the City's complaints relate to the requirement that Illinois-American seek a variance under the Commission's Main Extension Deposit Rule ("Rules") authorizing the arrangement with the City for the Hanna Steel project. As Illinois-American points out, when extending water mains it applies the Rules, which ensure that existing customers are not required to unfairly subsidize a main extension for a new applicant by paying water rates that reflect a disproportionate cost of constructing an extension. [IAWC Exs. 11.0R, p. 10-12; 2.0 pp. 15-17.] The Rules are incorporated into the Company's tariffs filed with the Commission. Any variance to the Rules must be approved by the Commission. Under the Rules, applicants requesting that water mains be extended to serve their property are responsible for providing a deposit to fund the extensions, subject to certain credit and refund requirements set forth in the Rules. IAWC points out that, by requiring a developer to fund the costs associated with an extension of service, the developer must commit to the project. [IAWC Ex. p. 17.] As IAWC notes, the Rules do not discriminate against any applicant for an extension, and the deposit requirements for main extensions do not differ based on the location of a development relative to the City limits or the willingness of the developer to annex to the City. [IAWC Exs. 2.0, pp. 15-17; 11.0R, p. 13.] Under the Rules, the revenue generated by existing customers is not used to subsidize an extension of service.

IAWC points out that, in appropriate circumstances, it can request a variance from the Commission to cooperate with developers and the City in supporting

development. IAWC notes that an example would be the very Hanna Steel development about which Mr. Hierstein complains. [IAWC Ex. 4.0, p. 12-13, 15.] In 1998, the City obtained a grant for the construction of a water main extension to the Hanna Steel property, but the grant required the City to own the extension for five years. [Id.] Although such ownership by the City is contrary to the Rules, IAWC sought and expeditiously obtained a variance from the Commission to allow the City to maintain ownership of the main extension for the five year period required by the grant. [Id.]; IAWC Ex. 11.0R, p. 10.] In this manner, IAWC asserts that it was able to cooperate with the City and aid in development without placing the burden for the development on current customers through increased rates.

IAWC notes that the protections afforded customers under the Rules would be lost if the City were to acquire the system. [IAWC Ex. 11.0R, p. 9.] Although the City has said that, should it acquire the system, it plans to "initially" adopt the policies in force under Commission Rules, the City also admits that it will "review" and may modify those policies. [Tr. 104-105; Hierstein Aff. to Pet. ¶ 17.] Staff witness Johnson testified that he is concerned that the City may adopt policies that discriminate against non-resident customers. [Tr. 102.] And, the City has affirmatively stated that it "may condition access and extensions of the existing [water] system to new customers upon annexation." [Tr. 105-106; Hierstein Aff. to Pet. at ¶ 19.] According to IAWC, the City's statements thus demonstrate that it intends to discriminate against non-residents by conditioning extensions of service on annexation, and will offer to assist applicants of its choosing in funding of main extension, thus requiring the existing customers to subsidize service to the new customers. [IAWC Ex. 2.0, p. 17.]

IAWC maintains that the only development "advantages" that Pekin could arguably gain by the proposed acquisition are the ability to force certain non-residents to annex in order to receive water service, and/or the ability to subsidize main extensions to favored developers, thereby forcing existing customers to subsidize those developers. IAWC notes that these "advantages" that Pekin seeks are contrary to the Rules, and not in the public interest. See, e.g., Illinois-American Water Company, Docket No. 96-0007, pp. 10-11 (June 26, 1996).

With respect to cooperation regarding development projects, the evidence demonstrates that current coordination between the IAWC and both the City and developers is excellent. [IAWC Exs. 4.0, p. 10; 11.0R, p. 8.] Contrary to the City's assertions, IAWC points out that the evidence shows that IAWC actively supports economic development in Pekin and the surrounding areas, within the terms of the Rules, and coordinates with both the City and developers to do so. [IAWC Ex. 4.0, p. 12-13, 15.]

e. The City's Claim Regarding Additional Jobs

The City claims that its acquisition will provide additional jobs in Pekin. Mr. Hierstein cited additional jobs as one reason supporting condemnation in both his direct testimony and the affidavit he filed in support of the City's petition. [Pekin Ex. 1.0, p. 6; Hierstein Aff. to Pet., p. 2.] However, as Illinois-American points out, Mr. Hierstein

later contradicted himself when he stated, in rebuttal testimony, that the number of water system employees would decrease under City ownership. [Pekin Ex. 7.0, p. 6.] The City has also suggested that IAWC employees will be given the opportunity to continue employment under City ownership. [Pekin Ex. 6.0, p. 4.] IAWC notes, however, that all of the City's statements are unsubstantiated, as the City has not developed any detailed plan for operation of the water system or provided an organizational chart showing the staffing assignments, levels, or division of responsibility between the anticipated contract operator and the City. [IAWC Ex. 4.0R, pp. 2-3.]

f. The City's Claim that the City's Condemnation Plan has Voter Support

Shortly after the City's Water Study Task Force Report was issued in 1999 recommending, with some qualifications, that the City pursue acquisition of the Pekin District system, IAWC notes that it initiated an advisory referendum to ensure the City did not proceed with a forced acquisition of IAWC without first obtaining direct voter input. [IAWC Ex. 5.0, p. 9.] IAWC notes that the 2000 referendum asked voters the following straight-forward question:

Shall the City of Pekin, Illinois, purchase the facilities and business of Illinois-American Water Company which serve the Pekin area?

[IAWC Ex. 5.0, p. 10; Ex. 5.5.] According to IAWC, 54% of those voting in the referendum voted against acquisition of the water system. [Id.]

IAWC states that, in March 2002, triggered not by service issues or complaints (indeed, there have never been any complaints submitted by the City to the Commission), but by announcement of the sale of IAWC's parent company stock to RWE, the City again placed the acquisition issue before the voters in an advisory referendum. As noted above, in Docket 01-0832, the Commission approved the RWE transaction and found that "customers will benefit". [IAWC Ex. 1.0, p. 5.] According to IAWC, rather than placing a straightforward referendum on the ballot (comparable to the 2000 referendum), the City worded the referendum as follows:

Given the proposed sale of our local water company to a large, foreign corporation, should the city council take the necessary steps, including eminent domain, to obtain the water company, in order to preserve American ownership and obtain local control?

[IAWC Ex. 5.0, p. 14, Ex. 5.9.]

IAWC points out that the result of the 2002 referendum was a 61% vote in favor of preserving "American" ownership. [Pekin Ex. 1.0, p. 8.] IAWC notes that the results of the referendum do not represent the opinions of the significant number of Pekin District customers who reside outside the City limits. [IAWC Ex. 5.0, p. 9.] IAWC, however, further points out that the referendum results are not reliable as a true gauge of the views of the City residents. According to IAWC, in addition to being a thinly-veiled appeal to citizen concerns (soon after the then-recent September 11 attacks), the

referendum language was misleading and confusing to voters in two respects. First, the language refers to the "sale" of the "local" water company. As noted above, the RWE transaction was not a "sale" of IAWC, and certainly not a sale of a Pekin "local" water company, but instead involved a transfer of the stock of American to RWE. Also, according to IAWC, the language of the referendum asks the voters if they want to preserve "American" ownership of the system, which, as demonstrated by a voter survey conducted by IAWC, could have easily been read by voters to refer to a retention of ownership by "American" Water, which continues to own Illinois-American, just as it did before and after both the referendum and the RWE transaction. [IAWC Exs. 5.0, p. 15, Ex. 5.10; 11.0R, p. 12.]

g. Financial Feasibility and Future Rate Increases

According to Illinois-American, the Commission's public interest analysis should include a comprehensive examination of the effect of the condemnation proposal on rates and service that would be provided customers of the Pekin District. All parties acknowledge that the price that Pekin would have to pay to acquire the Pekin District system would affect both Pekin's ability to proceed with the transaction and the rates which it would be required to charge water customers to finance the transaction. In fact, the City's own Water Study Task Report specifically determined that the "purchase price should be no more than 20,000,000" for the transaction to be financially feasible. [IAWC Ex. 7.1.] Accordingly, Illinois-American maintains that it is necessary for the Commission to consider evidence concerning valuation of the Pekin District property in this context. In other words, meaningful evidence of the value that would be placed on the Pekin District is an important part of the public interest analysis given its impact on future rates.

Pekin compares the Pekin District rates to those in effect in certain other communities, and concludes, based on the comparison rates selected, that the Pekin District rates are higher. As explained above, however, IAWC asserts that Pekin's analysis ignores the fact that many municipal water systems have higher rates for non-residents, while the Pekin District does not. Furthermore, as Mr. Ruckman explained, rate comparisons would be meaningful only to the extent that the comparison system is similar to that of the Pekin District. [IAWC Ex. 2.0, p. 13.] IAWC notes that neither Mr. Hierstein nor Ms. Hals make any effort to show that the systems referred to are comparable and, for that reason, IAWC maintains that the comparisons are meaningless.

IAWC explains that as set forth in the testimony, the only meaningful valuation evidence that has been presented is that of Illinois-American's experts Robert Reilly and Richard Riethmiller [IAWC Exs. 10, 10R and 9.] As reflected below, Mr. Reilly found that the fair market value of the Pekin System equals at least \$60,300,000. [IAWC Ex. 10, p. 15.]

To demonstrate the extreme adverse impact to the public interest that would result from increased rates due to City ownership, Mr. Ruckman made certain basic adjustments to the rate model submitted by Pekin's valuation consultant, Leta Hals, to

more accurately reflect the value of the Pekin System and the increased costs that the City would incur due to elimination of access to American Water system efficiencies.

For the Pekin stand-alone analysis, IAWC witness Ruckman made the following adjustments to the Hals' model:

- a. The assumed purchase price of the Pekin System was increased to the minimum valuation as determined by Mr. Reilly of \$60,300,000;
- b. Base year manpower and labor expense was increased by \$160,000 to reflect an estimated additional five employees who would be needed to operate the Pekin System (an unchallenged IAWC estimate);
- c. Health insurance costs were increased to reflect Pekin's loss on a stand-alone basis of the mass purchasing power of American System. For example, the City pays approximately \$1,100 per month for a family health insurance policy, whereas the Company pays approximately \$800 per month;
- d. The Company's allocation of management fees to Pekin was eliminated and replaced by an estimated \$340,000 for outside professional fees that would be incurred to replace the services now provided by the service company; and
- e. IAWC's fourteen union employees' wage rates were reduced by 3% to match the City union rates, resulting in an approximately \$20,000 reduction for this expense under City ownership.

[IAWC Ex. 2.0R, p. 17-18.]

As Illinois-American explains, to demonstrate the difference between City stand-alone ownership and continued IAWC ownership, Mr. Ruckman also calculated the estimated future rate increases for IAWC ownership, using Ms. Hals' methodology. IAWC states that the comparison is very telling, for under continued IAWC ownership based on Ms. Hals' model, the expected cumulative rate increase over the next ten years is approximately 6.08% or an average increase of only about .6% annually. [IAWC Ex. 2.0R, p. 18; 2.3R.] However, under Pekin stand-alone ownership, the ten year cumulative rate increase, based on the City's model, is a dramatic 104.74%, or an annual average increase of about 10.48%. [*Id.*; IAWC Ex. 2.2R.] According to IAWC, the Ruckman rate analysis demonstrates that Pekin's claim of a five year rate freeze after City ownership is unattainable. As Mr. Gloriod explained, such a freeze on rates could only happen with a deferral of essential spending for both maintenance and capital programs. As a result of the deferral of programs, IAWC maintains that the condition of the water system would quickly deteriorate in the same way as Ms. Ciccone's testimony described has occurred for many years in the City's wastewater operation. [IAWC Ex. 1.0, p. 11.]

IAWC further maintains that the City's entire financial feasibility and rate projection contentions are based on the speculations of an unqualified witness whose valuation analysis is inconsistent with generally accepted appraisal standards and Illinois law.

(i) Ms. Hals' Witness Qualifications

According to IAWC, the initial question to answer in regard to the analysis of Ms. Hals' testimony is how credible is that testimony and what weight, if any, it should be given. IAWC believes that the cross-examination of Ms. Hals at the hearing demonstrates that she is not qualified and does not have the appropriate training, certification, designations, or experience necessary to perform an appraisal or testify concerning the fair market value of the Pekin System. Ms. Hals is not a member of the American Society of Appraisers, the Association for Investment and Management Research, the American Institute of Certified Public Accountants, or the Appraisal Institute. [Tr. 441 - 442.] Similarly, she holds no appraisal designations from any of these organizations. Ms. Hals did indicate that she was a member of the Institute of Business Appraisers, but had only joined within the last two weeks. Ms. Hals is not a state-certified general appraiser in the State of Illinois or any other state, and does not hold any appraisal designations from any appraisal-certifying associations. [Tr. 443.] Similarly, she has never qualified as an expert appraisal witness in any contested proceeding, and has no formal educational training in civil engineering. [Tr. 443.] Ms. Hals is not familiar with and has never read the Principles of Appraisal Practice and the Code of Ethics promulgated by the American Society of Appraisers ("ASA"). Ms. Hals admitted that she could not testify that her valuation analysis conforms with the ASA Appraisal Standards.

According to IAWC, Ms. Hals' qualifications and experience do not match those of Mr. Reilly, who holds numerous professional appraisal certifications and designations, including designation as: (1) a certified public accountant (Illinois and Ohio); (2) an Accredited Senior Appraiser; (3) a Certified Management Accountant; (4) a Certified Business Appraiser; (5) a Certified Real Estate Appraiser; and (6) a State Certified General Appraiser in Illinois. [IAWC Ex. 10, 4-5.] In addition, Mr. Reilly has significant experience in all forms of business valuation and has qualified on numerous occasions as an expert witness. [Id.]

IAWC maintains that the valuation analysis contained in the RFC report and in Ms. Hals' testimony are flawed. According to IAWC, Ms. Hals' analysis begins with an incorrect premise by following a pre-determined view as to the desired result.

(ii) Assumption that Original Cost Rate Base ("OCRB") Equals Fair Market Value

According to IAWC, the City disregarded Illinois law and generally accepted appraisal standards and equated the OCRB of the Pekin System to its fair market value. In fact, as IAWC points out, Pekin's income approach is specifically geared to reach a number which is equal to OCRB. As Mr. Reilly testified, no calculation that begins with

historical cost and diminishes the value of assets irrespective of their actual condition is a fair reflection of the fair market value. [IAWC Ex. 10, pp. 19-20.]

IAWC notes that fair market value and rate base are two distinct and separate concepts. "Fair market value" is essentially the value-in-exchange between a hypothetical willing buyer and a willing seller, which is determined by consideration of multiple measures, including an analysis of the cost to reproduce the assets ("RCNLD"), the income producing capacities of the assets, and market transactions of assets comparable to the subject. "Rate base," by contrast, is the dollar amount on which a regulatory agency (1) calculates rates of service and (2) allows a utility to earn a return. [IAWC Ex. 10, pp. 12-13.] According to IAWC, courts have repeatedly held that, in the context of determining just compensation in a condemnation action, "original cost" and "present fair market value" are not equivalent terms. See, e.g., Washington Suburban Sanitary Com'n v. Utilities, Inc. of Maryland, 775 A.2d 1178, 1197 (Md. Ct. App. 2001) (noting the "complete lack of similarity between the original cost used in rate making and the just compensation for the purpose of taking.") (internal citations omitted); Dade County v. General Waterworks Corp., 267 So. 2d 633, 640 (Fla. 1972) (observing that original cost does not equate with value; and holding that "the complete dissimilarity between rate-making concepts and the just or full compensation standards which govern eminent domain have resulted in rejection of attempts to equate rate-making with eminent domain as a basis for determining fair market value."); City of Phoenix v. Consolidated Water Co., 415 P.2d 866, 870 (Ariz. 1966) (noting that "while original cost is admissible in evidence, it should have little if any value for the determination of what is fair and equitable in a condemnation action."); United California Bank v. Prudential Ins. Co. of America, 681 P.2d 390, 428 (Ariz. Ct. App. 1983). ("Original cost is admissible in evidence, but is never controlling In short, 'original cost' and 'present value' are not equivalent terms."); City of South Bend v. Users of Sewage Disposal Facilities of Clay, 402 N.E.2d 1267, 1274 (Ind. Ct. App. 1980) (noting that original cost and present value are not synonymous terms); Onodaga County Water v. New York Water Service Corp., 139 N.Y.S.2d 755 --- (1955) (rejecting rate base as an indicator of fair market value).

Illinois-American points out that, as determined in Illinois, rate base is the original cost of certain specified utility assets derived from an accounting of the utility's historical investment, less book depreciation. IAWC states that this accounting calculation, which is essentially net book value, is not an appropriate fair market value analysis of a utility's assets. Utility cash flows are likely to have far greater value in the market place than the net book value of the assets that generate them, and utilities frequently own significant intangible assets that are not typically reflected in rate base. [IAWC Ex. 10, p. 13.]

On cross-examination, Ms. Hals could not direct the Commission to any appraisal authority that equates original cost with market value, except for the case of a brand new property (which, of course, the Pekin District is not). [Tr. 450.] Since the City equates the valuation of the Pekin System to its original cost rate base, IAWC asserts that its analysis is fundamentally flawed.

(iii) Special Use Property

(a) The Pekin System is Special Use Property

In a typical eminent domain action, IAWC states that the proper measure of condemnation damages is the "fair cash market value" ("fair market value") of the property that a hypothetical willing buyer will pay to a hypothetical willing seller, except in the case of "special use property." 735 ILCS §5\7-121. Normally, the payment of the fair market value is sufficient to make the owner of the property whole, and satisfies the constitutional requirement that property may not be taken by condemnation absent payment of just compensation. However, as the evidence presented by IAWC establishes, in the case of "special use property" fair market value is not an appropriate measure of compensation in a condemnation action. IAWC notes that, in the case of special use property, the property's particular use may very well limit the number of potential buyers in the market and thus render it impractical and/or impossible for the owner to sell the property for its true fair market value.

According to IAWC, under Illinois law, the legal determination of whether property is special use property is made through a multi-factor analysis applied on a case-by-case basis. IAWC points out that a special use and/or special purpose property is a "limited-market property with a unique physical design, special construction materials, or a layout that restricts its utility to the use for which it was built." Appraisal of Real Estate, 12th Ed., Ch. 2, P. 25. See also, Nichols, Eminent Domain, Section 12.32. Special use property includes property which has no record of comparable sales which have similarities such as locality, character, time, proximity, market conditions, improvements, and mode of payment. See People v. Young Women's' Christian Assoc. of Springfield, 387 N.E.2d 305 (Ill. 1979). When a property has special capabilities which make it unmarketable at its true value due to the unique improvements, it constitutes a "special use" and as such, fair market value is not a legally sufficient measure of compensation. See People Ex. Re. Director of Finance v. YWCA, 74 Ill. 2d 561, 569 (1979); Housing Authority v. Kosydor, 17 Ill. 2d 602, 606, 162 N.E.2d 357, 359 (1959); see also Peoples Gas & Light v. Coke and Buckles, 24 Ill. 2d 520, 531 - 32, 182 N.E.2d 169 (1962); Lakeshore & Michigan Southern Ry. Co. v. Chicago & Western Indiana R.R. Co., 100 Ill. 21, 33 (1881) (railroad transfer station designated as special use property since it was not available for general and ordinary purposes and had no market value as such).

In the case of special use property under Illinois law, IAWC notes that replacement or reproduction is the preferred method of valuation, not fair market value. Chicago City Bank & Trust Co. v. Ceres Terminals, Inc., 417 N.E.2d 798, 803 (Ill. App. Ct. 1981) (noting that "in condemnation cases involving these 'special use' properties, therefore, a standard of compensation other than fair market value may be used, such as replacement cost."); County of Cook v. City of Chicago, 84 Ill. App.2d 301, 228 N.E.2d 183 (1st Dist. 1967) (accepting replacement cost is appropriate valuation method for special use property); City of Chicago v. George F. Harding Collection, 70 Ill. App.2d 254, 217 N.E.2d 38, 1 (1st Dist. 1966) (same); see also YWCA, 387 N.E.2d 305. According to IAWC, this is consistent with the law in other jurisdictions in regard to valuation of special use property. See e.g., Massachusetts-American Water Co. v.

Grafton Water District, 631 N.E.2d 59, 61 (Mass. Ct. App. 1994) (holding the accepted way to determine fair market value for special use property is reproduction cost less depreciation); see generally, 4 Nichols on Eminent Domain § 14A.06(e) (noting that RCNLD is the preferred approach in valuing special use property).

Illinois-American explains that the Pekin System qualifies as special use property under Illinois law. [IAWC Exs. 10, p. 6; 10R pp. 6-7.] According to Illinois-American, the Pekin System is devoted to the special purpose of supplying fire protection and potable water to the public, and the market for such a water system is limited in nature. While there are no Illinois eminent domain cases involving valuation of utilities, other jurisdictions have held that utility property is special use property. See e.g., Massachusetts–American Water Co. v. Grafton Water District, 631 N.E.2d 59, 61 (Mass. Ct. App. 1994) (noting that a public utility is considered a special purpose and holding that, when the property taken by eminent domain is a special purpose property, the accepted way to determine fair market value is reproduction cost less depreciation).

(b) RCNLD Analysis

IAWC asserts that, because the Pekin System is special use property, under Illinois law, Reproduction Cost New Less Depreciation ("RCNLD") is the appropriate method to determine the value of the property in an eminent domain action. RCNLD is a method under the asset-based cost approach of estimating the cost of reproducing the water treatment, storage and distribution assets of the Pekin System with substantially identical property under current conditions, and deducting observed depreciation. [IAWC Ex., p. 3.] Richard Riethmiller, with the engineering firm of Burgess & Niple, performed the RCNLD analysis in this action and submitted testimony reflecting his findings. IAWC explains that the RCNLD method is a detailed engineering analysis which includes (1) the preparation and verification of a detailed inventory of all tangible assets of the utility; (2) the estimation of the current cost of each of those inventory items in order to calculate the Reproduction Cost New of the system; and (3) adjustment of the total cost by the "observed depreciation," which is measured by physical inspection. [IAWC Ex. 9, p. 5.] As opposed to simply using book depreciation (an accounting calculation), IAWC notes that Mr. Riethmiller did a thorough inspection of the system to verify its existing condition and remaining useful life in order to determine the total RCNLD value of the system. [IAWC Ex. 9, p. 5.]

According to IAWC, Mr. Riethmiller's analysis is a standard procedure and process that he has conducted on numerous occasions. He based his observed depreciation assessment on a very conservative approach, and found that the Reproduction Cost New of the Pekin assets should be adjusted by a factor of thirty-one to thirty-nine percent (31 - 39%) to reflect the observed depreciation. According to Illinois-American, the RCNLD value for the tangible assets ranges from a low of \$60,300,000 to a high of \$68,000,000. [IAWC Ex. 9, p. 7.]

IAWC points out that the City did not submit any testimony whatsoever to rebut the testimony of Mr. Riethmiller in this proceeding, and did not elect to cross-examine Mr. Riethmiller at the hearing.

IADC notes that Mr. Reilly utilized the RCNLD value of the tangible assets determined by Mr. Riethmiller in his valuation of the Pekin System. In Mr. Reilly's opinion, the minimum value of the Pekin System is at least \$60,300,000. The reason he indicates that this is the minimum value is that the number does not include the value of the land or the value of the operating intangible assets which are associated with the Pekin System, such as computer software, customer and billing records, system maps and technical records and a trained and assembled workforce. In his view the land obviously has value, and based on his analysis he concludes that the intangibles associated with the Pekin System also will have considerable additional value. Since the \$60,300,000 minimum value for the tangible assets of the Pekin System far exceeds what the City indicated at the hearing it would pay for the system, Mr. Reilly concluded that there was no need to finalize the valuation of the intangibles and land at this time. [IADC Ex. 10, p. 11.]

IADC also notes that Ms. Hals disregarded the RCNLD method in her analysis. IADC maintains that this position is unfounded. IADC maintains that water system engineers, such as Mr. Riethmiller, are skilled at determining through inspection and testing the current condition and life expectancy of the water system property, including underground distribution lines. [IADC Ex. 10, pp. 20-21.] Ms. Hals also contends that the RCNLD method is simply too "complex." Mr. Reilly, however, testified that RCNLD estimates are routinely calculated in condemnation and other valuation cases. [IADC Ex. 10, p. 21.] As IADC points out, the objective of the valuation analysis should be to produce an accurate estimate of the fair market value of the Pekin Water System as Mr. Reilly has done in this case, not to avoid all possible complexity in the valuation process as Ms. Hals has done. [IADC Exs. 10, p. 21; 10R, p. 12.] Accordingly, IADC maintains that the reasons given by Pekin's purported valuation consultant to ignore the RCNLD method of valuation completely fail under analysis.

(c) No Market Comparability

In her valuation, Ms. Hals ignores the fact that the Pekin System is special use property. Ms. Hals incorrectly contends that "any sales" of water systems, irrespective of their comparability to the Pekin System or their proximity in time, are sufficient to remove the Pekin System from the category of "special use property." [IADC Ex. 10R, p. 12.] In her rebuttal testimony, Ms. Hals listed what she believed were transactions involving water companies dating back to 1975. She admitted that she had performed no research of any of the transactions listed on Attachments A or B of her rebuttal testimony necessary to assess comparability. [IADC Ex. 10R, p. 5; Ex. 10.1R (Pekin's Responses to Illinois-American's Sixth Data Request Nos. 3, 5, 8, 10 and 13).]

IADC notes that Mr. Reilly reviewed the transactions on Ms. Hals' list and determined that a number of the "transactions" were not sales at all. These were, instead, simply combinations of entities already owned by a single holding company. [IADC Ex. 10.0R, p. 5.] According to IADC, Mr. Reilly also found that the five alleged sales transactions that Ms. Hals reviewed as a "reasonableness check" were not sufficiently comparable to Pekin in order to draw any meaningful valuation conclusions. Unlike the Pekin System, the transactions involved stock acquisitions of large, multi-

state water systems. IAWC asserts that Ms. Hals made no attempt to relate or compare the properties acquired in these transactions to the Pekin System in terms of condition, size, customer base, expected growth, source of supply, investment, risk, or any other key valuation variables, and admitted this failing at the hearing. [IAWC Ex. 10R, p. 6.]

As IAWC points out, the sole basis Ms. Hals cites for not viewing the Pekin system as special use property is that there is a market for the system, although by her own admission, she did not perform a market analysis and made no effort to try to prove the comparability of any of the transactions she identified on Attachments A and B to her rebuttal testimony. Accordingly, IAWC notes that there is no proof submitted by Pekin to rebut the testimony of Mr. Reilly concerning the non-comparability of market sales in regard to the Pekin System.

(iv) Fair Market Value Analysis

Unlike Ms. Hals, Mr. Reilly performed an analysis of the fair market value of the Pekin System in the unlikely event that an Illinois court may subsequently find that the Pekin System does not constitute special use property. IAWC maintains that, in his fair market value analysis, Mr. Reilly followed accepted appraisal standards and analyzed the three generally accepted approaches for appraisal of a business enterprise, the asset-based cost approach (RCNLD method), the income approach and the market approach. A fundamental step under the income approach is to determine the most likely population of hypothetical willing buyers. In this instance, Mr. Reilly determined that the most likely population of hypothetical willing buyers is comprised of municipal entities. [IAWC Exs. 10, p. 25; 10R, p. 14.] According to IAWC, Mr. Reilly's conclusions were predicated on several factors. First, the vast majority (approximately eighty percent (80%)) of water systems in the United States are owned by municipalities. In the case of the Pekin System in particular, it is surrounded by several municipal authorities that represent potential buyers such as: Tazewell County; the cities of Pekin and Peoria; Cincinnati, Elm Grove, Pekin and Groveland townships; and existing or potential water districts in the area. Second, the Pekin System is relatively small and is located in the geographic territory where IAWC is the principal investor-owned water supplier. Therefore, according to IAWC, it is unlikely that investor-owned utilities would be interested in pursuing an acquisition of the Pekin System on a "stand-alone" basis.

(a) RCNLD Analysis

The positions of Illinois–American and the City with respect to RCNLD were discussed above.

(b) Income Capitalization Analysis

Even assuming that the Pekin System is non-special use property, IAWC maintains Ms. Hals' purported fair market value analysis contains additional flaws because it relies exclusively on the income approach and not the cost (RCNLD) or market approaches. According to IAWC, Ms. Hals compounds this error by refusing to recognize that the most likely hypothetical willing buyer is a governmental entity which

would generally have (1) a lower cost of capital than a comparable investor-owned company, (2) increased retained earnings based on non-liability for income, sales and property taxes, and (3) no regulatory process to prevent increases in rates as needed. [IAWC Ex. 10, pp. 17, 25.]

IAWC points out that standard appraisal practices dictate that financial projections under the income approach would reflect financial performance of the expected population of hypothetical buyers, which in this case are government entities. [IAWC Ex. 10, p. 25.] By totally rejecting governmental entities as potential hypothetical buyers in her income analysis, Ms. Hals has intentionally structured the calculation in order to equate original cost rate base and fair market value. Accordingly, IAWC notes that Ms. Hals has understated cash flow by not adjusting revenues for income, sales and property tax, which will not be paid by the hypothetical governmental entity buyer, and using the improper discount rate which would generally be lower for a typical governmental entity as compared to a typical investor-owned utility.

In his critique of Ms. Hals' discounted cash flow analysis, Mr. Reilly corrected the fundamental error referenced above and assumed the likely buyer was a governmental entity. In correcting this error, Mr. Reilly made two changes to Ms. Hals' income approach analysis. First, he used a discount rate equal to the cost of capital for a public entity buyer. The rate utilized was five percent (5%), which was slightly higher than the average municipal bond yield for bonds rated AAA by Moody's Bond Rating Service as of October 31, 2002. Second, Mr. Reilly added back to projected distributed income in Ms. Hals' discounted cash flow model the projected income, sales and property taxes, which were improperly deducted as expenses by Ms. Hals in her income approach analysis. Once these two corrections were made to the income approach analysis, the indicated market value of the Pekin System assets totaled at least \$70,000,000. [IAWC Exs. 10, p. 26; 10.1.] IAWC notes that this result serves as a check that the present value of the cash flows generated from the Pekin System, assuming a governmental entity as the hypothetical willing buyer, correlates extremely well with Mr. Reithmiller's minimum RCNLD value of the tangible assets at \$60,300,000. [Id.]

(c) Market Analysis

IAWC explains that, in his market analysis, Mr. Reilly identified and researched transactions involving sixteen companies, eight private and eight public. [IAWC Ex. 10R, pp. 6-7; 10, p. 14.] His analysis verified that none of the transactions were sufficiently comparable to the Pekin System and as a result, did not provide meaningful financial data from which to determine an opinion of value. [Id.] This fact also confirms his opinion that Pekin constitutes special use property. Accordingly, Mr. Reilly's final conclusion of the value of the Pekin System is that it will exceed \$60,300,000. [IAWC Ex. 10, p. 15.]

(d) City's Feasibility Analysis

Mr. Reilly noted that Ms. Hals did not perform a fair market value appraisal of the Pekin System. Instead, Ms. Hals performed a "feasibility analysis," which is distinct from

a fair market value analysis. [IAWC Ex. 10R, pp. 9-10.] A feasibility analysis is defined as "an analysis undertaken to investigate whether a project will fulfill the objectives of the investor. The profitability of the specific real estate project is thus analyzed in terms of the criteria of a specific market or investor." Appraisal of Real Estate, 12th Ed., p. 283 (Appraisal Institute, 2001). This approach contrasts with a fair market value analysis which, as Mr. Reilly explains, "estimates the price at which ownership of a property or system would transfer between willing, well-informed and rational hypothetical seller." [IAWC Ex. 10R, p.9.] According to Mr. Reilly, in a fair market value analysis, the characteristics of a specific investor are irrelevant. By not considering the proposed Pekin transaction from the willing buyer/willing seller perspective (i.e., fair market value) as required under Illinois law, IAWC maintains that Ms. Hals' analysis has no credibility.

According to IAWC, the only evidence regarding rate and financial matters that is based on a valuation methodology consistent with Illinois law is that presented by Illinois-American.

(v) The City's Proposed Rate Freeze and the Funding Needs of the Water System

The City claims that it will freeze water rates for five years should it be successful in acquiring the water system. [Pekin Ex. 15.1.] However, Pekin witness Hals admitted that the ability of the City to freeze rates and continue to operate the Pekin water system as a self-sustaining unit is wholly dependent on the "price the City pays for the system." [IAWC Ex. 7.0R, p. 2.] As explained by IAWC witness Mary Kane, the testimony of IAWC witnesses Reilly and Ruckman, described above, shows that Ms. Hals' valuation method should not be accepted. [Id.; Section III(C)(7).] In addition, as Ms. Kane explained, a significant problem with Ms. Hals' analysis of the rate freeze is that neither the City nor Ms. Hals conducted a comprehensive feasibility analysis of system operations or requirements that looked at the entire operation from a historical and capital improvement perspective. [IAWC Ex. 7.0R, p. 9.] Given the City's position that it would freeze rates and its unavoidable need for excess capital to fund the acquisition and maintenance of the system, Ms. Kane notes that the City's other potential sources of capital must be analyzed.

Ms. Hals relies on statements from Mr. Hierstein that, should it need to do so, the City could fund additional capital improvements through City reserves. However, IAWC maintains that, at best, the City's General Fund is distressed. A review of the City's General Fund financial statements indicates that in 2002 the City had an overall decrease in revenues of 13%, approximately a 16% decrease in Sales and Other Use Taxes, and a 19.6% decrease in its fund balance. [IAWC Exs. 7.0, p. 5; 7.3.] In addition, as of April 30, 2002, the City had \$11,860,122 in its General Fund undesignated reserves. [IAWC Ex. 7.0R, p. 13.] This was a 19.59% decline from fiscal year ("FY") 2001 alone. However, this 19.59% decline is less than half of the decline projected to occur between FY 2002 and 2003. [Id.; IAWC Ex. 7.3R.] Thus IAWC points out that the City has gone from a nearly \$12 million reserve balance in April, 2002 to a \$5 million balance for FY 2003. IAWC maintains that the City's finances leave it ill-equipped to fund the acquisition and capital needs of the water system.

Mr. Hierstein asserts that the City could supplement capital improvements through state and federal loan and grant programs. [Pekin Ex. 1.0, pp. 17-18.] However, IAWC maintains that this approach also fails. As explained by IAWC witness Kane, public water suppliers no longer have unlimited state and federal loan and grant programs available to them. [IAWC Ex. 7.0, p. 16.] Given the City's home-rule status in a metropolitan region, with a population exceeding 30,000, IAWC maintains that the City now has few options. [Id., pp. 16-18.]

Since the City cannot subsidize the water system and cannot obtain grants and loans to make capital improvements, should the City acquire the system and keep its pledge to freeze rates, IAWC maintains that the City will have no choice but to defer capital and maintenance costs. [IAWC Ex. 7.0R, p. 3.] An example of the potential problems is Pekin's operation of the City's sewer system and the impact of that operation on the City's Sewer Fund. The City points to its low sewer rates. [Pekin Ex. 1.0, pp. 15-16, IAWC Ex. 7.0, p. 11.] However, in the years FY 1999, 2000, 2001 and 2002, the City has had a negative net income balance and a declining Sewer Fund balance. [Id., p. 15.] And as of December 2002, the Sewer Fund had a net income of negative \$595,641. [Id., p. 12; IAWC Ex. 7.13.] Finally, as of April 2002, the Sewer Fund had an ending fund balance of \$340,878, which is a 67% decline since 1999. [Id., p. 15.] IAWC points out that, as demonstrated by Ms. Ciccone's testimony, the City's refusal to charge sufficient sewer fees has had an adverse impact on the operation of the wastewater system.

2. The Alternatives Presented

Illinois-American explains that, as discussed above, the Commission's role is to determine whether the City, which carries the burden of proof, has demonstrated that the condemnation it proposes is in the better public interest as compared to the continuation of ownership by Illinois-American. IAWC's description of the alternatives is summarized below.

a. Continued Ownership by Illinois-American

(i) History of American System Operation

American acquired ownership of Pekin Water Works Company, and that company was then merged into Illinois-American in 1982. The area previously served by Pekin Water Works Company became the Pekin District. At the time of acquisition, the general condition of the Pekin District was fair. The major problems identified in the system centered on high unaccounted-for water ("UFW") and inefficient manual operation of the water system. [IAWC Ex. 3.0, p. 2.] UFW for the Pekin District was above the industry maximum standard of 15% for most years immediately prior to American's acquisition of the system. In fact, UFW was 31% in 1981---the year American purchased the Pekin Water Works Company. [IAWC Ex. 3.0, p. 2.]

Major improvements initiated at the outset to address the UFW included: (1) replacement of older small diameter water mains; (2) replacement of older galvanized

service lines; (3) replacement of older untested residential meters; and (4) replacement of untested large meters without detector check valves. Since IAWC's acquisition, UFW has steadily declined and has averaged approximately 5.4% for the last ten years. IAWC states that this is testament to Illinois-American's efforts to provide for accurate measurement of water usage and to reduce leakage through replacement of old service lines and small diameter water mains.

The improvements initiated in the early stages of the acquisition to address the inefficient manual operation of the system included the replacement of the manual operating system with a SCADA system. In 1983/1984, Illinois-American made an initial investment of \$130,000 in a new SCADA system. This system was later updated and improved in 1994 at a cost of \$394,000. [IAWC Ex. 3.0, p. 2.] These improvements provide both efficiency of operation and consistency of control over the entire system, and allow Illinois-American to rapidly respond to changing water demands within the system that require varying well withdrawal and reservoir levels on a daily basis. [IAWC Ex. 3.0, pp. 2-3.]

IAWC Exhibit 3.3 presents a graphical history of the total capital investment made by American and Illinois-American in the Pekin District from 1981 through 2001. The total Company investment over that time frame is \$14,378,844. [IAWC Ex. 3.0, p. 6.] The linear investment trend line shown on Exhibit 3.3 has a slope of 7.5%, which indicates the Company's investment over this 20-year period has exceeded the Consumer Price Index of 4.7% for the same time period. [Id.]

(ii) The Capital Planning Process

Capital improvement needs are addressed through Illinois-American's comprehensive planning process, which provides a structured method for the Company to continually analyze both short-term and long-term needs, develop cost-effective solutions to meet those needs, and prioritize planned future capital improvements. [IAWC Ex. 3.0, pp. 3-4.] The planning process is designed to produce a comprehensive and detailed long-term strategy that is constantly evolving in response to ever-changing conditions affecting the system. Illinois-American's comprehensive planning process has two main components: (1) a Comprehensive Planning Study ("CPS") that represents Illinois-American's best efforts to formulate an elaborate 15-year plan is completed and updated every 5 to 7 years; and (2) yearly reviews conducted as part of the Annual Business Plan ("ABP") process to reassess the CPS priorities based on the most current information.

(iii) Illinois-American's Operating Practices

Under operation by Illinois-American, there are fourteen field service positions at the Pekin District, including two working foremen who collectively accomplish all the routine day to day service operations including meter reading, turning water on or off for customers, checking and repairing valves, hydrants, water main leaks and so forth. [IAWC Ex. 3.0, p. 4.] This workforce also operates the wells, treatment facilities, pump stations and storage facilities. These fourteen positions are supervised by the

Operations Supervisor who reports to the Operations Superintendent, Randy West. Mr. West holds the top position in Pekin and is assisted by the Operations Coordinator and the Distribution Clerk. These latter two positions are office positions that provide secretarial, clerical and the administrative support to Mr. West and help customers who seek assistance at the local office. [Id.]

In addition to the personnel assigned directly to the Pekin District, IAWC notes that other resources of Illinois-American and the American system are available as needed to support the District's operations. [IAWC Ex. 1.0, p. 7.] As IAWC points out, resources available to the Pekin District include the Division Manager, Kevin Hillen, and administrative support staff in the Peoria Office, a short distance away. The staff in the Peoria office include specialized maintenance support and computer hardware/software support. Resources available to the Pekin District from the Belleville Corporate Office include professional management and administrative staff covering all areas of expertise in accounting and finance, legal, human resources, water quality, engineering, safety and loss control. In addition, Belleville is the site of a statewide service center that processes service orders for all districts including Pekin. American Water Service Company, Inc.'s ("AWWSC") national laboratory for processing water quality samples is also located in Belleville. The Pekin District is able to take advantage of statewide and national contracts for purchase of everyday materials from office supplies and cell phones, to pipe, chemicals and meters. Also, American's national call center allows Pekin District customers to use a toll-free number to call the Company 24 hours a day, seven days a week, to reach a trained individual who can respond to customers' service needs or questions in over 100 different languages. [IAWC Ex. 2.0, pp. 19-20.]

In addition to the resources available in the State, the expertise of American is at the disposal of the Pekin District to help with specialized services available for projects like the Granular Activated Carbon (GAC) Contactor project and the CPS. [IAWC Ex. 1.0, p. 4.] The Pekin District also benefits from American Water Capital Corp., which provides Illinois-American with a global reach for the attraction of capital on favorable terms. [Id.]

As IAWC witness Gloriod explained, if the City's proposal were approved, the Illinois-American and American system resources used by the Pekin District would no longer be available. [IAWC Ex. 1.0, p. 8.] The City would not have professional senior management or adequate administrative staff. There also would be only limited laboratory facilities (the local operations lab in Pekin, as described by Mr. Gregory) and no accounting or customer information systems, no full service laboratory facilities, no engineering department, no financing department, and the City would lose Illinois-American's ready access to capital. The Pekin District system also would lose the local neighbor support of the Peoria District. Service functions and administrative functions performed in Belleville for Pekin would cease. Pekin's customers would also lose the use and benefits of AWWSC's national call center. [IAWC Ex. 2.0, pp. 19-20.] In addition, the water system would suddenly have no national contracts for purchase of materials and would not be able to produce the same discounts for materials that are afforded by the mass purchase and national contracts discussed by IAWC witness Ruckman. [IAWC Ex. 1.0, pp. 8-9.]

(iv) Conditions in the Water Industry

As Mr. Gloriod explained, the water/wastewater industry is facing huge challenges. [IAWC Ex. 1.0, p. 11.] Most systems need to replace the first generation of buried pipes that distribute potable water. These piping systems were installed decades ago at a cost of perhaps only a \$1 per foot. Today, water main replacement can cost an average of \$60 per foot. This is occurring at a time when more and more stringent environmental rules are being promulgated, putting additional pressure on capital dollars. IAWC notes that these conditions and possible remedies are addressed in a recent report by the USEPA, The Clean Water and Drinking Water Infrastructure Gap Analysis, United States Environmental Protection Agency (2002) ("EPA Report"). [IAWC Exs. 1.0, p. 9; 1.1.]

As Mr. Gloriod indicates, the EPA Report quantifies the gap between current spending and current needs for infrastructure. For wastewater, USEPA's point estimates of the gap range from \$21 to \$122 billion over the next twenty years. [IAWC Ex. 1.1, p. 25.] For drinking water, the gap is estimated to be from \$45 to \$102 billion over the next twenty years. [*Id.*, p. 38.] USEPA notes that, for the overall industry, the gap disappears with an increase in spending of 3% per year over inflation. [IAWC Ex. 1.1, Executive Summary, p. 1.] The EPA Report concludes by listing a number of research needs, among them the need to research "restructuring, integrating, and amalgamating service providers to seek economies of scale in the provision of service." [IAWC Exs. 1.0, pp. 9-10; 1.1, p. 44.]

Illinois-American notes that, as in the case of other water systems, the Pekin District also faces the prospect of increased costs. As discussed above, using Ms. Hals' model (with certain adjustments), Mr. Ruckman calculated the percentage increases in rates that would occur under continued IAWC ownership with Commission oversight as compared to Pekin's stand-alone proposal. For continued IAWC ownership, Mr. Ruckman determined that a rate increase over 10 years of approximately 6.08%, or an average increase of only about .6% annually, would be expected. [IAWC Ex. 2.0R, p. 18.] As Mr. Ruckman indicates, the ten-year cumulative increase under Pekin stand-alone ownership is a far higher 104.74%, or an annual average increase of about 10.48%. As Mr. Gloriod explained, however, whether the actual need for increased annual revenue under Pekin stand-alone ownership is 10.48% on average, as calculated by Mr. Ruckman using Ms. Hals' model, or 3% (plus inflation), as estimated by USEPA for the overall industry, it is clear that the Pekin District will require additional revenue and that, if the City were to acquire ownership and implement a rate freeze, the water system soon would not realize enough revenue from water sales to properly maintain and operate the system. [IAWC Ex. 1.0, pp. 10-11.]

Mr. Gloriod noted that the Pekin District exhibits a need for infrastructure investment that is typical of older systems in the water industry. [IAWC Ex. 1.0, p. 11.] As a result of IAWC's careful planning and aggressive programs discussed above, the Pekin District system is well-maintained and in good condition as compared to other water systems of similar age. As explained above, however, future capital projects are needed to address the Pekin District's aging infrastructure and significant water quality

concerns. [IAWC Ex. 3.0, pp. 10-18.] As Mr. Gloriod indicated, the cost associated with the required projects would be far higher than these amounts if the City were to undertake this work as a small stand-alone system. [IAWC Ex. 1.0, pp. 11-12.]

Mr. Gloriod explained that the Pekin District presently faces many of the same challenges experienced by the water industry nationwide. Illinois-American's studies show that, as in similar communities, the average water use per customer is also declining in the Pekin District. In 1982, average use was about 190 gallons per day per residential customer. In 2001, use has dropped from 1982 levels by 10 gallons per day. [IAWC Ex. 1.0, p. 14.] Thus, as Mr. Gloriod indicates, the water industry and the Pekin District face increasing spending requirements, occurring at a time of minimal customer growth and a pattern of declining sales. [IAWC Ex. 1.0, p. 14.] This results in pressure to reduce costs to offset the declining sales and/or to increase prices.

As Mr. Gloriod explained, Illinois-American's strategy to respond to these concerns has been and continues to be to reduce costs through technology improvements and consolidation of managerial and administrative functions, and to reduce water leakage. [IAWC Ex. 1.0, p. 14.] The same pressures will exist on any system owner. As a stand-alone, however, the City of Pekin would not realize efficiencies of the magnitude generated by the American system. [IAWC Ex. 1.0, p. 14.] IAWC notes that the expected future rate increases based on Ms. Hals' model (as adjusted by Mr. Ruckman) are far less under Illinois-American ownership (on average, .6% annually) than are the increases under City ownership (on average, 10.48% annually).

Mr. Gloriod pointed out that, in the past, small water systems, such as a Pekin stand-alone, have in many cases been able to maintain adequate levels of service. [IAWC Ex. 1.0, p. 16.] For the important reasons discussed by Mr. Gloriod, however, this situation is changing. When costs are fixed, the cost of service per customer declines as customers are added (mitigating the need for increased water rates). As a result of consolidation, therefore, water utilities will experience economies of scale and, thereby lower the amount of cost increases or lengthen the time between rate cases. Larger water utilities, such as Illinois-American, also reduce costs per customer by expanding the scope of services that they provide, thereby spreading costs further. [IAWC Ex. 1.0, p. 15.]

For the reasons discussed, it is necessary for Illinois-American, and all water utilities, to achieve cost-effective customer growth. As explained above, however, if the City of Pekin were to acquire the Pekin District water assets, Illinois-American's cost advantages would be eliminated. [IAWC Ex. 1.0, p. 15.] Also, the remaining customers of Illinois-American would face higher rates, as there would be fewer customers to cover certain fixed administrative costs. [Id., p. 15.] Mr. Ruckman discusses the adverse impact that the loss of the Pekin District would have on the level of common cost per customer and rates for Illinois-American's remaining service areas. [IAWC Exs. 2.0; p. 12, 2.0R, p. 19.]

In addition to the need to reduce operating costs and attract capital, water systems, such as the Pekin District, also will require skilled personnel to address

operating and capital needs. As explained by IAWC witness Stack, the City has no experience in operating a water system. [IAWC Ex. 11.0R, p. 9.] As Mr. Gloriod indicated, the City's ability to attract and retain talented personnel would not compare to the ability of Illinois-American which can offer competitive salaries and advancement opportunities including relocation to nearly anywhere in the United States, and perhaps the world, due to the merger with Thames/RWE. [IAWC Ex. 1.0, p. 17.]

b. City Stand-Alone

The City proposes to acquire ownership of the water system and suggests that it may require assistance from an unidentified outside entity in operating the water system. [Pekin Ex. 2.0, p. 8.] The City further indicates that it does not see any significant "downsides" or "difficulties" associated with its proposal to acquire the Pekin District assets. [Pekin Ex. 2.0, p. 11.] According to Illinois-American, however, the City's lack of awareness is explained by its lack of analysis or advance planning with regard to its proposed acquisition. As discussed above, the City has no specific plan for either operating the water system, or for future capital additions. [IAWC Ex. 1.0, p. 20.] As noted above, the City also has not chosen a contract operator nor has it revealed minimum qualifications or resources that the contract operator will provide. [IAWC Ex. 1.0R, p. 3.] Staff witness Thomas Q. Smith found "no plan or evidence" at all supporting the City's assumption that a contract operator would be hired. [Id.]

IAWC maintains that information about how the water system would be operated, what capital investment would be made, cost of service, and system practices and policies under City ownership would be essential to an understanding of how a City takeover would affect the water system's resident and non-resident customers. According to IAWC, because the City has not provided this information, it is simply impossible to conclude that the City has met its burden of proof with regard to the better public interest.

3. Legal Authority to Proceed with the Condemnation

As discussed above, in examining the condemnation proposed in Fernway, the Commission began its review by considering whether the Sanitary District had the required authority to proceed with the condemnation it proposed. As explained by the Commission:

It is no argument to say that the question of whether or not the district has the authority it claims is one which will be determined by the court in subsequent eminent domain proceedings. The Commission, on many occasions, and this is one, must make an original interpretation of law. The Commission should not be in the position of saying, in effect, 'we believe what you propose is illegal but we approve'.

(Docket 52024, Order, p. 6.) Thus, Illinois-American maintains that consideration of the District's authority to proceed is a necessary component of the public interest analysis.

According to IAWC, the City is a municipality within the meaning of the Illinois Municipal Code (the "Code"). 65 ILCS 5/1-2. The City also is a "home rule" unit within the meaning of Article VII of the 1970 Illinois Constitution ("Article VII"). Ill. Const. of 1970, art. VII, § 6. Under Article VII, a home rule unit "may exercise any power and perform any function pertaining to its government and affairs." Ill. Const. of 1970, art. VII, § 6(a). Furthermore, the Illinois Supreme Court has indicated that, pursuant to Article VII, a home rule unit may enact an ordinance empowering it to condemn property within its corporate limits, subject to the eminent domain procedures established by statute. City of Carbondale v. Yehling, 96 Ill. 2d 495, 451 N.E.2d 837 (1983). The procedure for exercise of eminent domain authority is governed by the EDA.

IAWC notes, however, that in this proceeding the City's condemnation proposal extends to areas beyond its corporate limits. Specifically, the City proposes to acquire and operate the "waterworks and related properties" of Illinois-American that are "now utilized in the furnishing of water service to the residents of the City of Pekin and surrounding area." Thus, the City proposes to acquire the entire Pekin District of Illinois-American. [Pet., ¶¶ 4, 6.]

According to IAWC, the Illinois courts have made clear that a municipality's home rule power under Article VII does not provide authority to condemn property beyond its corporate limits. In City of Peoria v. Keehner, 115 Ill. App. 3d 130, 135, 449 N.E.2d 1376, 1379 (3d Dist. 1983), the Illinois Appellate Court held that a home rule unit "has only such power to condemn land beyond its boundaries as is granted to it by the legislature" Accordingly, to support its proposal, IAWC notes that the City must rely on a specific statutory grant of authority to condemn property outside of its corporate boundaries.

The City represents [Pet., ¶ 3] that it has authority to proceed with its plan under Division 130 of the Illinois Municipal Code ("Division 130"). See 65 ILCS 5/11-130-9. In fact, Pekin attached to its Petition City Ordinance No. 2289, which purports to authorize the City's representatives to initiate this proceeding. The Ordinance indicates expressly that the City relies on Division 130 for its authority to proceed in this matter.

As noted above, however, to condemn property outside of its corporate limits Illinois law requires that a municipality rely on express statutory authorization to do so. City of Peoria, 115 Ill. App. 3d at 135. As IAWC points out, however, Division 130 does not refer at all to an authority to condemn property beyond corporate limits. Furthermore, the law is clear that statutes conferring the power to take private property in derogation of individual rights must be construed strictly, and that the exercise of that power must be kept strictly within the bounds of the authorizing statute. See Village of Bolingbrook v. Citizens Utility Co., 267 Ill. App. 3d 358, 359, 642 N.E.2d 182, 184-84 (3rd Dist 1994) (construing Division 130 strictly against a municipality seeking to condemn a waterworks). Thus, IAWC notes that Division 130 must be construed strictly and cannot be read to grant condemnation authority that it does not expressly reference.

Illinois-American maintains that the fact that Division 130 does not grant authority to condemn property outside corporate limits is made clear by the fact that another Division of the Illinois Municipal Code, Division 117 (65 ILCS 5/11-117), does, in certain

circumstances, grant such authority by its express terms. Illinois State Toll Highway Auth. v. Karn, 9 Ill. App. 3d 784, 787-88, 293 N.E.2d 162, 165 (2d Dist. 1973) (use of certain words in one instance of statutory language and use of different words in another instance indicates that the legislature intended different results); see also People v. K.C., 186 Ill. 2d 542, 549-50, 714 N.E.2d 491, 495 (1999) ("It is well established that, by employing certain language in one instance and wholly different language in another, the legislature indicates that different results were intended."). Division 117 provides that, "any municipality . . . may sell water within and outside the corporate limits of the municipality from any water plant owned and operated by the municipality" 65 ILCS 5/11-117-4. The Division further authorizes the use of condemnation authority for this purpose. 65 ILCS 5/11-117-7. Division 117 contains a restriction, however, that a municipality may own and operate a public utility only if "the majority portion [of the utility service] is or is to be supplied to the municipality or its inhabitants." 65 ILCS 5/11-117-1. Thus, according to Illinois-American, Division 117, unlike Division 130, provides a statutory basis for a condemnation outside corporate limits, provided that Division 117's requirements are satisfied.

Illinois-American suggests that the City's selection of Division 130 as the statutory vehicle for its condemnation scheme may be attributable to the fact that one of Division 117's requirements is that residents of a municipality approve action taken under that Division in a clear and objective referendum. The Section also sets forth a required form for the referendum. 65 ILCS 5/11-117-3. In the Ordinance attached to its Petition in this matter (Ord.2289, p.1), the City makes reference to an advisory referendum in which, according to the City, City residents voted in favor of its acquisition effort. As discussed above, however, the City's confusing referendum which did not conform to Division 117's requirements and which asked voters to indicate whether they were for or against "American ownership" in the context of an "American" Water system company is meaningless. [IAWC Ex. 5.0R, p. 2.] Moreover, Mr. Hillen, Illinois-American's Northern Division Manager, provided undisputed testimony that the City did not conduct the straightforward referendum described by Division 117. [d.] Thus, IAWC maintains that the City did not and is not in a position to invoke authority under Division 117, and has no authority to proceed with its condemnation proposal under Division 130.

C. Staff Position

Staff witness Johnson identified the interests of non-residents as an area of concern in his Direct Testimony, submitted at the same time as Illinois-American's direct evidence. After reviewing all of the direct evidence, Staff witness Johnson recommended in Rebuttal Testimony that the City's petition be denied, because the City had failed to adequately address the concern regarding possible discrimination against non-residents in rates and service, and had not met its burden of proving that condemnation is in the better public interest of all customers, both residents and non-residents.

Further, as recognized by Staff witness Johnson, under IAWC ownership, all customers are subject to the same rates, rules, regulations and conditions of service

regardless of whether they reside within the City's municipal boundaries. IAWC's obligation to provide service on a non-discriminatory basis is codified by statute (220 ILCS 5/8-101), and is enforced by Commission supervision. Consistent with this obligation, the Pekin District system is designed and operated on a regional basis, without any recognition of municipal boundaries. IAWC provides service at the same rates to both City residents and non-residents. As Staff witness Johnson opined, the City has failed to demonstrate that the same will occur under City ownership.

As Staff witness Johnson observed that as of the time that he submitted his Rebuttal Testimony, the City had not made an effort to pass a resolution, ordinance or anything else guaranteeing the protection of customers who reside outside the City. Following the filing of Staff witness Johnson's rebuttal testimony, the City Council passed a new resolution, Resolution No. 5, on May 5, 2003. However, as stated by Staff witness Johnson, Resolution No. 5 does not assuage his concerns because "there is really nothing said in there about the protection of customers outside the city." As Staff witness Johnson explained at the Hearing, the Resolution does not give non-residents a mechanism to protect themselves - - they don't have a vote. [Tr. 89-90.] Staff witness Johnson further stated that there are "no guarantees." The non-resident customers would be powerless to stop such an action, since they have no vote. Staff witness Johnson specifically found that "[c]ommitments made by one administration do not necessarily continue under new administrations."

V. COMMISSION CONCLUSION

The Commission has reviewed the evidence and arguments of the parties and concludes, based upon the record presented, that the relief requested in the Petition must be denied. In reaching this conclusion, the Commission resolves three basic issues. The first issue is whether the request for eminent domain authority passes muster under Division 130 of the Municipal Code. Second, whether Staff's concerns about the potential disparate of residents living outside the Pekin City limits *per force* requires the denial of the relief requested. Third, whether the City's evidentiary showing, when viewed in the light of all of the evidence adduced by all of the parties, was sufficient to compel the conclusion that awarding eminent domain authority would be in the public interest. We turn now to a discussion of those issues *seriatim*.

A. Division 130

Distilled to their minimum, the Utility's arguments relating to the applicability of Division 130 are a basic syllogism. The major premise is that Division 130 does not confer any authority to condemn extraterritorial utility plant. The minor premise is that because it does not some other section of the Municipal Code must be relied upon. The conclusion is that some other provision (Division 117) must apply leading to the various arguments concerning the failure of the City's proof and process under that Division.

As a threshold matter the Commission observes that the syllogism has a faulty major premise in that Division 130 allows the Commission to grant the authority to condemn utility property outside city limits. In particular, Division 130-1 authorizes any

municipality to purchase a waterworks. Division 11-130-9 confers eminent domain authority upon a municipality for the purpose of purchasing any waterworks. Division 11-130-2 defines a "waterworks" a waterworks "in its entirety or any integral part thereof, including mains, hydrants, meters, valves, standpipes, storage tanks, intakes, wells, impounding reservoirs, or purification plants." 65 ILCS 5/11-130-2. Division 11-130-2 makes no reference to the location of the physical plant and, in our opinion leads to the conclusion that Division 11-130 is not confined to the purchase of waterworks located within a given municipal boundaries, but to any waterworks or integral part thereof, wherever the plant happens to be.

B. Public Interest Analysis

The first matter to be resolved is the requisite burden of proof that must be met by the City in prosecuting its case. The Commission determines that, under the public interest standard, it should examine competing proposals and approve the filed proposal only if it is shown to be "better" than the alternative. Therefore, the City has the burden to prove that a takeover of the water system by the City would better serve the public interest than continued ownership and operation of the Pekin District by Illinois-American.

The next matter to be determined is whether the City's case proves, by a preponderance of the evidence, that allowing the City to seek ownership of the waterworks would better serve the public interest. The prodigious evidentiary record and the prolix arguments relating to the public interest standard to be applied by the Commission in reaching its conclusion in this case were recited previously in this order and will not be repeated here. The Commission has reviewed the record and the parties' arguments and concludes that the City has failed in its burden of proving that granting eminent domain authority would better serve the public interest. In reaching our conclusion a number of observations are warranted.

The factor that the Commission finds most compelling in coming to its conclusion is the very rudimentary nature of the City's plans in the event that eminent domain were granted. Paramount in this matter is the City's failure to have even begun the process of selecting a system operator, which all parties agree will have to be done prior to the City taking the reins and providing service to the utilities' customers. Without some firm grasp over the identity of the system operator and the expense attributable to the operation, the Commission is entirely unable to judge the wisdom of turning such an important public service over to the city or to judge the impact of such a course of action. With the waterworks operated by the utility, the Commission is in a position to regulate the system operator and assure the continued viability of the service at just and reasonable prices.

Since the city would inevitably be free to change system operators to the detriment of its citizens, knowing the identity of the operator and the expense attributable to it, at the outset, would provide the Commission with some assurance that the public interest would be served, at least in the short run. In addition, any later attempt to diverge from the original planned course of action would be subject to public scrutiny

and input, whereas here the Commission is simply being handed the proverbial “pig in a poke,” but no reasoned basis upon which it can conclude that the system operator will be qualified or economical.

The failure of the city to identify the system operator or the expense of operations would, in our opinion cause this petition to be denied, without more. Nonetheless, there are other reasons that support our conclusion.

Staff Witness Johnson found that the City failed to adequately address the concerns regarding possible discrimination against nonresidents on rates and service. [ICC Staff Ex. 3.0, pp.5-7]. Staff Witness Johnson’s findings are relevant to the Commission’s public interest analysis. The potential for nonresident discrimination must be examined on a case-by case basis and weighted against the other evidence presented relevant to the Commission’s public interest analysis.

The Commission shares Staff’s concerns over the potential for disparate treatment of extraterritorial customers. While Division 130 may provide municipalities the right to condemn utility property outside of their territorial limits, the Commission retains its independent authority to consider whether an acquisition serves the public interest. In reviewing this public interest, the Commission is always free to differentiate between customers within and beyond municipal boundaries. The Commission recognizes that extraterritorial customers will no longer benefit from the service obligations and nondiscrimination provisions imposed on Illinois-American under the Public Utility Act. This would leave the extraterritorial customers without recourse, whether by direct electoral opportunities or to this Commission.

Furthermore, the Utility has noted, and the City has agreed, that there has been an ongoing dispute between the City and the IEPA over possible sewage contamination from the City run sewer system. Again, the City’s evidentiary response to this allegation gives the Commission little comfort in determining whether or not this is a matter of great or little import. The City’s response is that, while it doubts the veracity of the IEPA’s concerns, it has finally agreed to a remote inspection of the sewer system. This again leaves the Commission in the lurch in terms of judging the Cities ability to oversee its water system. The more pertinent issue is whether events such as those between the City and the EPA are commonplace and unremarkable or unusual and serious. Without such knowledge the Commission is in no position to judge the weight to be given them in judging the potential for similar events in relation to the drinking water system. Accordingly, the City has again failed in its burden of proving that granting it eminent domain authority would better serve the public interest.

The final matter that must be addressed is whether the City, in supporting its bid for eminent domain authority, proved that continued operation of the water system by the Utility, would not be in the public interest. In reviewing the evidence, the Commission concludes that none of the matters propounded by the City in support of its request require the Commission to conclude that the Utility has failed in its public duties.

The first matter alluded to by the City relates to the utilities maintenance of the fire protection system, notably instances of low fire hydrant pressure, improperly painted fire

hydrant caps and gravel in fire hydrant water flows. In terms of low pressure hydrants, IAWC responded that the only evidence offered to support that allegation, other than his recollection of undocumented problems at two fires that supposedly occurred "some years ago" (sometime during the 1980's), was the assertion that the fire department's failure to contain a March 3, 2002 fire at Jim's Automotive was caused by inadequate flow from the hydrants used to fight the fire, which the City contends was a direct result of smaller sized mains feeding the hydrants. [Pekin Ex. 3.0, p. 4.] IAWC notes that the Fire Department had no records of the amount of pressure available for fighting the fire or any other evidence to support this contention. Furthermore, IAWC notes that the assertion that the hydrants used to fight the fire were connected to small diameter mains is incorrect. According to IAWC, two hydrants used to fight the fire, both of which were less than 3 years old, are served by 6 inch mains. [IAWC Ex. 4.0, pp. 27-28.]

To resolve this matter, IAWC performed a hydraulic analysis which shows that the hydrants used to fight the fire actually produced between 1000 and 1600 gallons per minute at 20 psi, well above national fire protection standards, [IAWC Ex. 4.0, pp. 28-29.] while the City's estimates indicated that the hydrants produced at least 2900 gpm during the fire. [Tr. 435.] The City admitted that it had never contacted IAWC to request that larger mains be installed near the location of the fire. [*Id.*, 433.] In discussing the Jim's Automotive fire.

The Utility continued its response to these allegations by admitting that some mains in the system are below desired flows and that it has undertaken a program to replace 100% of all water mains 3 inches in diameter or less (or 75% of the mains 4 inches or less) in the Pekin system within 30 years. According to IAWC, this represents a replacement rate of 5,000 feet annually, which is triple the replacement rate of the last 20 years. The estimated cost for this replacement program is approximately \$300,000 per year.

The City also asserted that claims that IAWC fails to maintain operable hydrants. IAWC responded, and the Commission agrees, that the only evidence offered in support of this allegation was a reference to a January 5, 2002 fire where the City claims a hydrant was inoperable, that IAWC did not respond promptly to the fire department notification of the inoperable hydrant and did not repair the hydrant for over a month. IAWC responded that the hydrant had been inspected a few months before the fire and found in good working order; the hydrant was frozen, not broken, on the day of the fire; IAWC personnel responded to the call from the fire department, thawed the hydrant, and restored it to working order by the Monday following the fire on Friday. The City offered no response to these assertions.

In terms of the City's allegations of an ongoing problem of gravel in the mains, IAWC responded that the City had no records or documentation of any such problem; that there was no evidence that IAWC had been made aware of the perceived problem; and that it had made no efforts to complain, either in writing or verbally, about the problem to anyone at IAWC or the Commission. [Tr. 419-21.] As noted earlier, IAWC conducts a thorough inspection of each hydrant in the Pekin system annually. IAWC also conducts regular inspections of its well pumps. If there were a problem with gravel

in the mains for the past decade, IAWC states that it would have been evident in these inspections. [IAWC Ex. 4.0R, pp. 4-5.]

In terms of the City's criticism of IAWC for painting the fire hydrant bonnets according to main size, as opposed to flow, IAWC responded that it painted the hydrants according to main size because that is what the fire department requested. [IAWC Ex. 4.0, pp. 8-9.] IAWC provided the fire department with a map of the hydrants, and the fire department color coded the map according to the colors each hydrant should be painted. [Id.]

The Commission concludes that IAWC has addressed each of the stated reasons for the City's position that City ownership of the water system would better serve the public interest. For the reasons given by Illinois-American and discussed above, none of the City's reasons are supported by sufficient facts.

VI. FINDINGS AND ORDERING PARAGRAPHS

Having considered the entire record herein and being fully advised in the premises, the Commission is of the opinion and finds the following:

- (1) Illinois-American is engaged in the business of providing water and/or sanitary sewer services to the public in the State of Illinois and, as such, is a public utility within the meaning of Section 3-105 of the Illinois Public Utilities Act;
- (2) the City is a "municipality" within the meaning of the Illinois Municipal Code, 65 ILCS 5/1-2;
- (3) the Commission has jurisdiction over Illinois-American and the subject matter of this proceeding;
- (4) the recitals of fact set forth in the prefatory portion of this order are supported by the evidence of record and are hereby adopted as findings of fact;
- (5) for the reasons discussed in the "Commission Conclusion" (Section V above), the City's proposal is not in the public interest and should be denied;
- (6) any motions or objections or petitions in this proceeding that have not specifically been ruled on shall be disposed of in a manner consistent with the findings and conclusions herein.

IT IS THEREFORE ORDERED that the Petition filed by the City of Pekin is denied.

IT IS FURTHER ORDERED that any motions or objections or petitions in this proceeding that have not specifically been ruled on shall be disposed of in a manner consistent with the findings and conclusions herein.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Illinois Public Utilities Act and 83 Ill. Adm. Code 200.800, this Order is final; it is not subject to the Administrative Review Law.

By order of the Commission this 22nd day of January, 2004.

(SIGNED) EDWARD C. HURLEY

Chairman